Supreme Court, U.S.
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(14)

No. 91-1135

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

NEWARK MORNING LEDGER CO.,
as successor to The Herald Company,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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JOINT APPENDIX

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PETITION FOR CERTIORARI FILED JANUARY 13, 1992 –
CERTIORARI GRANTED APRIL 6, 1992

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Nov. 9, 1988—Plaintiff Newark Morning Ledger Co.'s complaint filed in U.S. District Court for the District of New Jersey, Newark Division.

Jan. 25, 1989—Defendant's answer filed.

Dec. 18, 1989—Final pretrial order filed.

Feb. 5, 1990—Non-jury trial of action commenced.

Feb. 8, 1990—Interim Order regarding refund of federal taxes and interest paid for taxes years 1977-1980.

Feb. 9, 1990—Non-jury trial of action completed, decision reserved.

Apr. 3, 1990—Opinion of the District Court finding in favor of plaintiff.

May 25, 1990—Judgment of District Court entered for plaintiff.

June 4, 1990—Amended Judgment of District Court entered for plaintiff.

July 24, 1990—Defendant's notice of appeal filed.

Sep. 12, 1991—Opinion and judgment of the Court of Appeals for the Third Circuit reversing District Court.

Sep. 26, 1991—Petition by appellee for rehearing in banc.

Oct. 15, 1991—Order Amending Opinion of the Court of Appeals for the Third Circuit.

Oct. 15, 1991—Order denying petition for rehearing in banc.

UNITED STATES DISTRICT COURT
FOF THE DISTRICT OF NEW JERSEY

Civil Action No. 88-4836
Judge HLS

NEWARK MORNING LEDGER CO., AS SUCCESSOR TO THE HERALD COMPANY,
Star Ledger Plaza,
Newark, New Jersey 07101,
Plaintiff,

v.

THE UNITED STATES OF AMERICA,
Defendant.

[Filed Nov. 9, 1988]

COMPLAINT

Plaintiff, Newark Morning Ledger Co. ("Morning Ledger"), by its attorneys, as and for its complaint against defendant, the United States of America, alleges as follows:

PARTIES, JURISDICTION AND VENUE

1. Plaintiff Morning Ledger is a corporation organized and existing under the laws of the State of New Jersey, having its principal place of business at Court Street and University Avenue, Star Ledger Plaza, Newark, New Jersey 07101. Morning Ledger is the successor corporation to The Herald Company ("Herald"), which was liquidated by merger into Morning Ledger on June 30, 1987 in a transaction governed by Sections 332 and 334 (b)(1) of the Internal Revenue Code of 1954 (the "Code"). For many years prior to June 30, 1987, both corporations were engaged in the business of publishing daily newspapers. Morning Ledger continues to be so engaged. Herald was the transferee of the assets of

Booth Newspapers, Inc. ("Booth"), which was liquidated by merger into Herald on May 31, 1977 in a transaction governed by Sections 332 and 334(b)(2) of the Code as in effect at that time. Defendant is the United States of America.

2. Jurisdiction over this action for the recovery of internal revenue tax erroneously and illegally assessed and collected by the Internal Revenue Service (the "Service") is invoked in this Court pursuant to 28 U.S.C. § 1346 (a)(1).

3. Venue is proper in this Court pursuant to 28 U.S.C. § 1402(a)(2).

FACTS COMMON TO ALL COUNTS

4. In this action, Morning Ledger challenges several erroneous determinations by the Service affecting the total tax assessment against its predecessor, Herald, for calendar and taxable years 1977 through 1980. First, Morning Ledger challenges the Service's erroneous determination of the total adjusted basis in the assets acquired by Herald in the liquidation of Booth. Second, Morning Ledger claims that the Service erroneously determined the fair market values of certain of the assets distributed, namely, Booth's stock in Parade Publications, Inc. ("Parade"), "going concern value," newspaper subscribers, and goodwill. Third, Morning Ledger claims that the Service erroneously interpreted and applied the law with respect to how total adjusted basis is allocated to the property distributed in the liquidation. These errors resulted in the incorrect determination of adjusted basis in each of the assets acquired by Herald in the liquidation of Booth. Finally, Morning Ledger challenges the Service's erroneous determination that the values attributable to "going concern" and newspaper subscribers are nondepreciable. All these errors by the Service resulted in an unlawful and wrongful income tax assessment against Herald for tax years 1977 through 1980 amounting to nearly $35 million.

5. Before merging into Herald, Booth was a Michigan corporation having its principal place of business at Ann Arbor, Michigan. Booth was engaged primarily in the publication of daily and Sunday subscription newspapers of general circulation in eight Michigan communities. Booth's wholly-owned subsidiary, Parade, published *Parade*, a nationally distributed Sunday newspaper supplement.

6. During the period beginning February 12, 1976 and ending November 5, 1976, Herald purchased all the outstanding stock of Booth for a total cash consideration of $304,680,145. As determined by the Service and accepted by Herald, acquisition costs associated with the purchase totaled $2,878,311 giving Herald an agreed adjusted cost basis of $307,558,456 in the Booth stock.

7. In a series of transactions beginning on April 7, 1976 and ending on May 3, 1976, Booth purchased over 95 percent of the common stock of ComCorp, Inc. ("ComCorp").

8. On March 15, 1977, Booth sold its ComCorp stock to an unrelated third party for $2,744,700. On May 31, 1977, Booth was liquidated by merger into Herald.

9. Herald's total adjusted and allocable basis in the assets acquired in the liquidation of Booth was $345,556,722, as determined in accordance with Section 1.334 of the Treasury Regulations. This basis consists of Herald's $307,558,456 adjusted gross basis in the Booth stock, plus (a) the unsecured liabilities of Booth of $29,305,324 assumed by Herald, and (b) Booth's earnings and profits of $8,692,943, realized during the interim period between November 5, 1976, the date the stock was acquired, and May 31, 1977, the date of liquidation ("interim E&P").

10. On May 31, 1977 the fair market values of Booth's assets were as follows:

Assets	Fair Market Values
Cash and Equivalents	$ 15,617,042
Securities	37,249,852
Accounts and Notes Receivable	15,046,899
Master Repurchase Agreements	3,100,000
Deferred Charges and Deposits	323,944
Inventories	3,435,627
Land	4,658,885
Land Improvements	1,721,959
Buildings & Improvements	21,350,237
Production Equipment	17,109,130
Computer Hardware & Peripherals	1,300,435
Furniture and Fixtures	880,775
Office Equipment	731,195
Autos and Trucks	234,489
Investment in Parade	55,000,000
Going Concern Value	18,728,000
Computer Software	1,658,000
Newspaper Subscribers	64,155,000
Goodwill	51,695,685
Total:	$313,997,154

11. In accordance with Section 1.334 of the Treasury Regulations, the total adjusted basis in the Booth assets is properly allocated as basis among the assets received (other than Cash and Cash Equivalents) in the proportion to which the fair market value of each such asset relates to the total fair market value of all such assets, except that the adjusted bases of Accounts and Notes Receivable and of Master Repurchase Agreements are limited to the face value of such assets. This allocation of basis is as follows:

Assets	Adjusted Basis
Cash and Equivalents	$ 15,617,042
Securities	41,444,891
Accounts and Notes Receivable	15,046,899
Master Repurchase Agreements	3,100,000
Deferred Charges and Deposits	360,426
Inventories	3,822,544

Assets	Adjusted Basis
Land	5,183,564
Land Improvements	1,915,884
Building and Improvements	23,754,678
Production Equipment	19,035,942
Computer Hardware	1,446,889
Furniture and Fixtures	979,967
Office Equipment	813,541
Autos and Trucks	260,897
Investment in Parade	61,194,032
Going Concern Value	20,837,128
Computer Software	1,844,722
Newspaper Subscribers	71,380,068
Goodwill	57,517,598
Total:	$345,556,722

12. Upon audit of Herald's federal corporate income tax returns for the years 1977 through 1980, the Service determined deficiencies in tax in the amounts of $3,780,889, $3,121,205, $3,786,791, and $3,576,546, respectively. These alleged deficiencies, as well as a portion of Herald's total tax liability for each of those years, resulted in part from the Service's erroneous determination of the adjusted basis in the assets received in liquidation of Booth and the total disallowance of deductions claimed for depreciation of certain intangible assets, specifically, "going concern" value and newspaper subscribers.

13. As part of its erroneous determination of adjusted basis in each of the assets, the Service made the following errors in calculating the total adjusted basis in the assets of Booth:

(a) determined the amount of unsecured liabilities assumed by Herald, which is included in the total adjusted basis in the Booth assets acquired, to be $29,046,308 as opposed to the correct amount, which is $29,305,324;

(b) reduced the amount of interim E&P to be included in the total adjusted basis from $8,692,943 to a deficit of $5,038,906 as a result of:

(i) a reduction in depreciation deductions in the amount of $3,473,515;

(ii) the inclusion of an asserted loss in the amount of $3,036,967 on the March 15, 1977 sale of the ComCorp stock;

(iii) the elimination of after-tax depreciation recapture income in the amount of $14,176,198; and

(iv) the use of figures for taxable income (after adjustments), federal income tax liability, and other minor adjustments in the computations which are incorrect because of the other errors set forth in this paragraph.

14. As part of its erroneous determination of adjusted basis in each of the assets, the Service incorrectly made the following changes in the fair market values of the Booth assets:

(a) increased the fair market value of the stock in Parade from $55,000,000 to $100,000,000;

(b) increased the fair market value of "going concern" from $18,728,000 to $32,400,000; and

(c) increased the fair market value of goodwill from $51,695,685 to $79,786,296.

15. As part of its erroneous determination of adjusted basis in each of the assets, the Service incorrectly determined that the difference between (a) Herald's adjusted cost basis in the stock of Booth, plus the amount of assumed, unsecured liabilities, and (b) the fair market value of the identifiable tangible and intangible assets of Booth is allocable entirely to "goodwill".

16. As a result of its erroneous determination of total adjusted basis in the assets, the Service incorrectly determined that Herald's adjusted basis in each of the assets received in the liquidation of Booth was as follows:

Assets	I Adjusted Basis Determined by Service	II Correct Adjusted Basis
Cash and Equivalents	$ 15,617,042	$ 15,617,042
Securities	36,665,098	41,444,891
Master Repurchase Agreements	3,051,336	3,100,000
Accounts and Notes Receivable	14,810,688	15,046,899
Deferred Charges and Deposits	318,859	360,426
Inventories	3,381,695	3,822,544
Land	4,585,751	5,183,564
Land Improvements	1,694,926	1,915,884
Buildings and Improvements	21,015,080	23,754,678
Production Equipment	16,840,549	19,035,942
Computer Hardware	1,280,019	1,446,889
Furniture and Fixtures	866,948	979,967
Office Equipment	719,716	813,541
Autos and Trucks	230,807	260,897
Investment in Parade	98,430,188	61,194,042
Going Concern Value	31,891,381	20,837,128
Computer Software	1,631,974	1,844,722
Newspaper Subscribers	—	71,380,068
Goodwill—Residual Value	78,533,801	57,517,598
Total:	$331,565,858	$345,556,723

17. To the extent the adjusted basis in the assets determined by the Service as set forth in Column I of the previous paragraph differs from the adjusted basis in the assets set forth in Column II of the previous paragraph, the determination by the Service is arbitrary, capricious and erroneous. The correct fair market values and adjusted bases of the assets received in liquidation of Booth are set forth in paragraphs 10 and 11, respectively.

18. In addition to incorrectly determining Herald's adjusted basis in the assets received in the liquidation of Booth, the Service arbitrarily, capriciously and erroneously determined (a) that "going concern value" is an asset without a determinable useful life, and therefore is not subject to the allowance for depreciation, and (b) that newspaper subscribers is an asset without a determinable useful life, and therefore is not subject to the allowance for depreciation.

19. As a result of the errors stated above, the Service erroneously and unlawfully assessed and collected an incorrect amount of tax against Herald for tax years 1977, 1978, 1979, and 1980.

COUNT I

Taxable Year: January 1 through December 31, 1977

20. Morning Ledger hereby incorporates by reference the allegations contained in paragraphs 1 through 19 of the Complaint.

21. Herald timely filed with the Service its federal income tax return (Form 1120) for its taxable year beginning January 1, 1977 and ending December 31, 1977 ("1977 Taxable Year"). The return showed a tax liability of $5,772,428, which amount was fully paid by Herald. Herald subsequently filed an amended federal income tax return (Form 1120X) for its 1977 Taxable Year showing an additional tax liability of $5,069, which was fully paid by Herald. On or about December 24, 1986, Herald paid an additional assessment with respect to the 1977 Taxable Year in the amount of $3,780,889, plus $5,355,346 in interest, or a total amount of $9,136,235. All assessments of tax and interest made with respect to plaintiff's 1977 Taxable Year have been paid in full.

22. By a series of agreements (Form 872) pursuant to section 6501(c)(4) of the Code, the limitations period in which to assess a deficiency in tax with respect to Herald's 1977 Taxable Year was extended to June 30, 1987, and the period in which a claim for refund could be filed with respect to that year was extended for 6 months thereafter, to December 31, 1987.

23. On October 27, 1987, Morning Ledger, as successor to Herald, filed a timely claim for refund (Form 1120X)

for its 1977 Taxable Year. A true and correct copy of this claim for refund is attached hereto as Exhibit A and incorporated herein by reference.

24. More than six months has passed since the date of filing the claim for refund set forth in the previous paragraph.

25. Morning Ledger is entitled to a refund in the amount of $10,454,272 for income taxes and interest paid for its 1977 Taxable Year based upon erroneous valuations, determinations, adjustments and allocations as described in the foregoing paragraphs. The failure of the Service to allow this claim for refund is arbitrary, capricious and unlawful.

26. By virtue of the facts set forth above, defendant is legally indebted to Morning Ledger in the amount of $10,454,272 for federal income taxes and interest paid thereof erroneously, unlawfully and wrongfully assessed and collected for the 1977 Taxable Year or such greater amount as legally may be refundable, plus interest as provided by law, and Morning Ledger is justly entitled to such amount which is due and owing from defendant.

COUNT II

Taxable Year: January 1 through December 31, 1978

27. Morning Ledger hereby incorporates by reference the allegations contained in paragraphs 1 through 19 of the Complaint.

28. Herald timely filed with the Service its federal income tax return (Form 1120) for its taxable year beginning January 1, 1978 and ending December 31, 1978 ("1978 Taxable Year"). The return showed a tax liability of $14,002,575, which amount was fully paid by Herald. Herald subsequently filed an amended federal income tax return (Form 1120X) for its 1978 Taxable Year claiming a refund of $333,413, which amount was

reduced by $5,069 to offset additional tax liability of Herald for its previous year. On November 14, 1986, Herald filed with the Service a waiver of notice of disallowance (Form 2297) with respect to this claim for refund. On or about December 24, 1986, Herald paid an additional assessment with respect to the 1978 Taxable Year in the amount of $3,131,205 in tax, plus $4,124,931 in interest, or a total of $7,246,136. All assessments of tax and interest made with respect to the 1978 Taxable Year have been paid in full.

29. By a series of agreements (Form 872) pursuant to section 6501(c)(4) of the Code, the limitations period in which to assess a deficiency in tax with respect to Herald's 1978 Taxable Year was extended to June 30, 1987, and the period in which a claim for refund could be filed was extended for a period of 6 months thereafter, to December 31, 1987.

30. On October 27, 1987, Morning Ledger, as successor to Herald, filed a timely claim for refund (Form 1120X) for the 1978 Taxable Year. A true and correct copy of this claim for refund is attached hereto as Exhibit B and incorporated herein by reference.

31. More than six months has passed since the date of filing the claim for refund set forth in the previous paragraph.

32. Morning Ledger is entitled to a refund in the amount of $8,192,314 for income taxes and interest paid with respect to its 1978 Taxable Year based upon erroneous valuations, determinations, adjustments and allocations as described in the foregoing paragraphs. The failure of the Service to allow this claim for refund is arbitrary, capricious and unlawful.

33. By virtue of the facts set forth above, defendant is legally indebted to Morning Ledger in the amount of $8,192,314 for federal income taxes and interest erroneously, unlawfully and wrongfully assessed and collected

for the 1978 Taxable Year, or such greater amount as legally may be refundable, plus interest as provided by law, and Morning Ledger is justly entitled to such amount which is due and owing from defendant.

COUNT III

Taxable Year: January 1 through December 31, 1979

34. Morning Ledger hereby incorporates by reference the allegations contained in paragraphs 1 through 19 of the Complaint.

35. Herald timely filed with the Service its federal income tax return (Form 1120) for its taxable year beginning January 1, 1979 and ending December 31, 1979 ("1979 Taxable Year"). The return showed a tax liability of $10,014,729, which amount was fully paid by Herald. On or about December 24, 1986, Herald paid an additional assessment of tax in the amount of $3,786,791, plus assessed interest in the amount of $4,557,838, or a total payment of $8,344,629. All assessments of tax and interest with respect to the 1979 Taxable Year have been paid in full.

36. By a series of agreements (Form 872) pursuant to section 6501(c)(4) of the Code, the limitation period in which to assess a deficiency in tax with respect to Herald's 1979 Taxable Year was extended to June 30, 1987, and the period in which a claim for refund could be filed was extended for an additional 6 months thereafter, to December 31, 1987.

37. On October 27, 1987, Morning Ledger, as successor to Herald, filed a timely claim for refund (Form 1120X) for the 1979 Taxable Year. A true and correct copy of this claim for refund is attached hereto as Exhibit C and incorporated hereinby by reference.

38. More than six months has passed since the date of filing the claim for refund set forth in the previous paragraph.

39. Morning Ledger is entitled to a refund in the amount of $8,576,523 for income taxes and interest paid for its 1979 Taxable Year based upon erroneous valuations, determinations, adjustments and allocations as described in the foregoing paragraphs. The failure of the Service to allow this claim for refund is arbitrary, capricious and unlawful.

40. By virtue of the facts set forth above, defendant is legally indebted to Morning Ledger in the amount of $8,576,523 for federal income taxes and interest erroneously, unlawfully and wrongfully assessed and collected for the 1979 Taxable Year, or such greater amount as legally may be refundable, plus interest as provided by law, and Morning Ledger is justly entitled to such amount which is due and owing from defendant.

COUNT IV

Taxable Year: January 1 through December 31, 1980

41. Morning Ledger hereby incorporates by reference the allegations contained in paragraphs 1 through 19 of the Complaint.

42. Herald timely filed with the Service its federal income tax return (Form 1120) for its taxable year beginning January 1, 1980 and ending December 31, 1980 ("1980 Taxable Year"). The return showed a tax liability of $9,425,510, which amount was fully paid by Herald. On or about December 24, 1986, Herald paid an additional assessment of tax with respect to the 1980 Taxable Year in the amount of $3,576,546, plus assessed interest in the amount of $3,626,369, or a total payment of $7,202,915. All assessments of tax and interest made with respect to Herald's 1980 Taxable Year have been paid in full.

43. By a series of agreements (Form 872) pursuant to section 6501(c)(4) of the Code, the limitations period in which to assess a deficiency in tax for Herald's 1980

Taxable Year was extended to June 30, 1987, and the period in which a claim for refund could be filed was extended for an additional 6 months thereafter, to December 31, 1987.

44. On October 27, 1987, Morning Ledger, as successor to Herald, filed a timely claim for refund (Form 1120X) for the 1980 Taxable Year. A true and correct copy of this claim for refund is attached hereto as Exhibit D and incorporated herein by reference.

45. More than six months has passed since the date of filing the claim for refund set forth in the previous paragraph.

46. Morning Ledger is entitled to a refund in the amount of $7,516,313 for income taxes and interest paid for its 1980 Taxable Year based upon erroneous valuations, determinations, adjustments and allocations as described in the foregoing paragraphs. The failure of the Service to allow this claim for refund is arbitrary, capricious and unlawful.

47. By virtue of the facts set forth above, defendant is legally indebted to Morning Ledger in the amount of $7,516,313 for federal income taxes and interest erroneously, unlawfully and wrongully assessed and collected for the 1980 Taxable Year or such greater amount as legally may be refundable, plus interest as provided by law, and Morning Ledger is justly entitled to such amount which is due and owing from defendant.

* * * * *

48. Herald was, and Morning Ledger as successor to Herald is, the sole and absolute owner of the claims presented herein, and there has never been an assignment or transfer of any of these claims, or any part thereof. No action on any of these claims has been taken by defendant or by any agency thereof other than the actions of the Service as described herein. No other suit or process on this claim is pending in any other court.

WHEREFORE, Morning Ledger demands judgment on COUNTS I, II, III and IV against the United States of America, as follows:

	Refund
COUNT I:	$10,454,272
COUNT II:	$ 8,192,314
COUNT III:	$ 8,576,523
COUNT IV:	$ 7,516,313
Total	$34,739,422

or such greater amount to which Morning Ledger may be entitled, together with interest, as provided by law, on the amount owed under each count, and the costs and expenses, including attorneys' fees, of this action and such further relief as the Court may deem just and proper.

Respectfully submitted,

/s/ Donald A. Robinson
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Dated: November 9, 1988

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(Exhibits Omitted in Printing)

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

(Title Omitted in Printing)

ANSWER

Defendant, the United States of America, through its attorneys, hereby answers the complaint as follows:

1. The Defendant currently lacks knowledge or information sufficient to form a belief as to whether the Plaintiff was incorporated under the laws of New Jersey, but it admits the remaining allegations contained in the paragraph.

2. The Defendant admits that this Court has jurisdiction pursuant to 28 U.S.C. § 1346(a)(1) but denies that the tax at issue was erroneously or illegally assessed and collected by the Internal Revenue Service.

3. The Defendant admits the allegations contained in the paragraph.

4. The Defendant admits the allegations contained in the first four sentences and in the sixth sentence of the paragraph, except that it denies that any of the subject determinations were erroneous. The Defendant denies the remainder of the allegations contained in the paragraph.

5-7. The Defendant currently lacks knowledge or information sufficient to form a belief as to the truth of the allegations of these paragraphs.

8. The Defendant admits that on May 31, 1977, Booth was liquidated by merger into Herald. The Defendant currently lacks knowledge or information sufficient to form a belief as to the truth of the remainder of the allegations of the paragraph.

9. The Defendant currently lacks knowledge or information sufficient to form a belief as to the truth of the allegations of the paragraph.

10-11. The Defendant denies the allegations contained in these paragraphs.

12. The Defendant admits the allegations contained in the first sentence of the paragraph. The Defendant denies the remainder of the allegations contained in the paragraph.

13-19. The Defendant denies the allegations contained in these paragraphs.

20. The Defendant incorporates by reference the answers to paragraphs 1 through 19 as set forth above.

21. The Defendant admits the allegations contained in the second and fourth sentences of the paragraph. The defendant denies that Herald's income tax return was timely filed but admits to the remainder of the allegations contained in the first sentence of the paragraph. The Defendant denies that the $5,069 was fully paid by Herald but admits to the remainder of the allegations contained in the third sentence of the paragraph. The defendant denies the allegations contained in the last sentence of the paragraph.

22. The Defendant admits the allegations contained in the paragraph.

23. The Defendant admits the allegations contained in the paragraph, except that the Defendant denies that the claim for refund was filed on October 27, 1987. The Defendant would admit that the claim for refund was filed on October 28, 1987.

24. The Defendant admits the allegations contained in the paragraph.

25-26. The Defendant denies the allegations contained in these paragraphs.

27. The Defendant incorporates by reference the answers to paragraphs 1 through 19 as set forth above.

28. The Defendant denies that Herald, as alleged in the first sentence of the paragraph, timely filed its federal tax return for the taxable year ending December 31, 1978 but would admit that the return was timely filed pursuant to an extension of the filing deadline to September 15, 1979. The Defendant denies that Herald, as alleged in the third sentence of the paragraph, claimed a refund in its amended federal income tax return for its 1978 Taxable Year of $333,413 but would admit that Herald claimed a refund of $338,413. The Defendant denies that Herald, as alleged in the fifth sentence of the paragraph, paid an additional assessment with respect to the 1978 Taxable Year of $3,131,205 but would admit that Herald paid an additional assessment of $3,121,205. The Defendant admits the remainder of the allegations contained in the paragraph.

29. The Defendant admits the allegations contained in the paragraph.

30. The Defendant admits the allegations contained in the paragraph, except that it denies that the claim for refund was filed on October 27, 1987. The Defendant would admit that the claim for refund was filed on October 28, 1987.

31. The Defendant admits the allegations contained in the paragraph.

32-33. The Defendant denies the allegations contained in these paragraphs.

34. The Defendant incorporates by reference the answers to paragraphs 1 through 19 as set forth above.

35. The Defendant denies that Herald timely filed its income tax retuurn for the taxable year ending December 31, 1979 but would admit that the return was timely

filed pursuant to an extension of the filing deadline to September 15, 1980. The Defendant admits the remainder of the allegations contained in the paragraph.

36. The Defendant admits the allegations contained in the paragraph.

37. The Defendant denies that Herald filed its claim for refund for the 1979 Taxable Year on October 27, 1987 but would admit that Herald filed its claim on October 28, 1987. The Defendant admits the remainder of the allegations contained in the paragraph.

38. The Defendant admits the allegations contained in the paragraph.

39-40. The Defendant denies the allegations contained in these paragraphs.

41. The Defendant incorporates by reference the answers to paragraphs 1 through 19 as set forth above.

42. The Defendant denies that Herald timely filed its federal income tax return for the taxable year ending December 31, 1980 but would admit that the return was filed timely pursuant to an extension of the filing deadline to September 15, 1981.

43. The Defendant admits the allegations contained in the paragraph.

44. The Defendant denies that Herald filed its claim for refund for the 1980 Taxable Year on October 27, 1987 but would admit that Herald filed its claim on October 28, 1987. The Defendant admits the remainder of the allegations contained in the paragraph.

45. The Defendant admits the allegations contained in the paragraph.

46-47. The Defendant denies the allegations contained in these paragraphs.

48. The Defendant admits that no action on any of these claims has been taken by the Defendant or by any agency thereof other than the actions of the Service as described in the Complaint. The Defendant denies the remainder of the allegations contained in the paragraph.

Wherefore, the Defendant prays that judgment be entered in its favor and that this Court issue an order dismissing the complaint and awarding defendant its costs and such further relief as this Court may deem just and proper.

Respectfully submitted,

SAMUEL A. ALITO, JR.
United States Attorney

By:
JEROME L. MERIN
Assistant United States Attorney

Of Counsel:

/s/ Gregory S. Hrebiniak
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(Certificate of Service Omitted in Printing)

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

(Title Omitted in Printing)

PLAINTIFF'S ANSWERS AND OBJECTIONS TO DEFENDANT'S INTERROGATORIES TO PLAINTIFF

* * * *

Interrogatory No. 9:

For each publication listed in the Answer to Interrogatory No. 7, (a) please describe the method used to circulate the newspapers, including but not limited to a description of the working relationships between the publication, its circulation department, the distributors and carriers and the methods they used to deliver the publications, paying particular attention to the way that the subscription lists were used and by whom to deliver the publications.

(b) In particular, for each of the publications, identify whether each of the entities in the circulation chain were employees of the publication or whether any were independent contractors.

(c) What contractual relationships existed between each publication and those who had possession of or access to its subscription lists.

Answer to Interrogatory No. 9:

1. Ann Arbor News

The circulation department of The Ann Arbor News consisted of a circulation manager, district managers and office staff, full-time and part-time, all of whom were employees of The Ann Arbor News.

The circulation manager oversaw the entire circulation department and the mailroom. The district managers each were assigned a geographic area in which they were responsible for dealing with about 125 carriers. It was the district manager's responsibility to contract with new carriers as needed, to make sure carriers paid their paper bills in a timely manner, and to encourage new sales through carrier contests and crew canvassing with their carriers. The office staff kept the department books and answered the telephones when either customers or carriers called with complaints or, in the case of carriers, to change the number of papers they needed.

Newspapers were transported to foot carriers and single copy locations from the plant dock area by several operator-owned pick-up trucks, all of whom were independent contractors.

Foot carriers, usually youngsters, would pick up their papers from their drops and then deliver to their individual customers on their paper routes. All foot carriers were independent contractors.

Adult motor carriers, all of whom were independent contractors, also picked up their papers from the dock area and then proceeded to deliver to their individual customers.

The contracts stated that subscription lists were the property of The Ann Arbor News. A carrier was required to turn in a list to the paper once a year, usually in February, or when the carrier went off his route. At all other times the carrier kept his own delivery list and informed the paper when he needed more or fewer papers to deliver to the customers.

2. Bay City Times

The Bay City Times had an employee staff of four district managers reporting to the circulation manager. Two district managers were assigned to the state area

supervising state and county motor route operators, agents and bundle haulers. The other two were assigned to supervise city carriers for city home delivery.

State motor route bundles were delivered by independent contract haulers to pick up sites in the state area. Bay County motor route operators picked up their bundles at the mailroom dock. City carrier bundles were delivered by Times-operated trucks and part-time employees (truck drivers).

Motor route operators and foot carriers were independent contractors, operating their own vehicles and delivering to individual subscribers and single copy outlets. Three motor route operators acted as distributors in Gaylord, West Branch and Tawas City and provided carrier home delivery in their respective cities, as well as covering the balance of their areas as regular motor routes.

Subscriber lists were maintained by each motor route operator and carrier for delivery and collection purposes. The newspaper was provided with a subscriber list whenever a carrier change was made, and then the newspaper provided the list to the new carrier.

The agreements with one or more of the special distributors identified above provided that the subscriber list for his area was the property of the distributor; however, the list was to be provided to The Times upon termination of the agreement.

3. Flint Journal

The Journal was delivered via Newspapers Deliveries, Inc. to carriers for conveyance to subscribers. Two types of contracts existed between the newspaper and these parties: one that governed the relationship between Newspapers Deliveries, Inc. and The Flint Journal, and the other between The Journal and the carriers. The former did not have any reference to subscriber lists, but instead referred to bundle identification, showing where the bulk

papers were to be dropped. The latter contracts provided that the subscriber lists were the property of The Journal, and were provided by The Journal to the carriers for delivery purposes only.

One type of motor route delivery was a mirror copy of the carrier delivery arrangement described above whereby Newspapers Deliveries, Inc. provided bundle drops to motor route agents. Another type of motor route delivery provided for conveyance of the newspapers directly to the motor route driver at The Journal's dock. In both cases, motor route drivers were governed by the same type of contract as the carriers, which is described above. Ownership of the subscriber list, used for delivery by the driver, remained the property of The Flint Journal.

Street sales were made by street sale agents, who were contractees under a separate agreement with The Journal. These were single copy sales; therefore, no subscriber list existed, other than a record of the locations of the boxes/sales. That information was referenced in the contract as belonging to The Journal.

Newspapers Deliveries, Inc. delivered bundles to newsstand locations for sale to the public as single copies. Newspapers Deliveries, Inc. was under contract for this delivery. No contract existed between the Journal and the newsstand sellers. Newspapers Deliveries, Inc. delivered bundles to schools for use in the classroom. No contract existed between the Journal and the schools, and no subscriber list was applicable.

Newspapers Deliveries, Inc. delivered sacks to the post office for delivery to mail subscribers who dealt directly with The Journal. The Journal maintained a complete address list of all of these subscribers.

The Journal had office-collect customers who paid The Journal directly for their subscription. A complete list of these customers was maintained by the newspaper. In turn, The Journal hired Newspapers Deliveries, Inc. to

deliver these papers every day directly to the subscribers homes. Additionally, employees of The Journal sold single copies directly to the walk-in public in the building lobby.

4. Grand Rapids Press

The Grand Rapids Press was delivered by carriers, motor route drivers and the U.S. mail. It was also sold through newsstands and vending machines. All of these methods of delivery, except the U.S. mail, were handled through a contractual agreement between The Press and the individuals involved. Circulation department members were employees of The Grand Rapids Press.

Under the agreements, subscriber lists were the property of The Press, and were provided to the carriers and motor route drivers by The Press for delivery purposes only and could not be used for any other purpose without the consent of The Grand Rapids Press. The lists had to be returned to The Press at the termination of the contract.

5. Jackson Citizen Patriot

The Patriot was delivered by motor route and carrier delivery. All motor route drivers and carriers were independent contractors.

The carriers generated handwritten lists which would be passed on to succeeding carriers, either in written form or by walking the route with the new carrier. The city carriers would often have a non-subscriber list, because such a list was easier to maintain. In either case, the list was maintained by the carrier, and provided periodically to the newspaper. The Patriot was further provided with a subscriber list whenever a carrier change was made, and then the Patriot provided the list to the new carrier.

The paper also had a total market coverage product (called the News Advertiser) delivered by independent contractors. Consultation between the district manager and the carrier produced a "route list" for that product, which was then kept and maintained by the carrier.

6. Kalamazoo Gazette

The Kalamazoo Gazette was delivered by carriers, motor route drivers and the U.S. mail. It was also sold through newsstands and vending machines. All of these methods of delivery, except the U.S. mail, were handled through a contractual agreement between The Kalamazoo Gazette and the individuals involved. Circulation department members were employees of the Kalamazoo Gazette.

Under the agreements, subscriber lists were the property of the Gazette, and were provided to the carriers and motor route drivers for delivery purposes only and could not be used for any other purpose without the consent of The Kalamazoo Gazette. The lists had to be returned to The Gazette at the termination of the contract.

7. Muskegon Chronicle

The Chronicle was distributed primarily through a system of youth carriers. There were 30-40 motor routes in rural areas and 5-6 adult carriers. All other delivery was by youth carriers. All carriers were independent contractors. In the late 1970's, two distributors were utilized in Muskegon Heights, each of whom controlled distribution of about 700 papers each.

Both The Chronicle and carriers had route lists. The lists were the property of The Chronicle. The carriers had the responsibility to update the lists periodically.

8. Saginaw News

The distribution force for The News consisted almost entirely of independent contractors, either youth carriers, adult motor route drivers, or adult agents within the City of Saginaw. In all cases, The News was sold wholesale to these individuals and they were responsible for the distribution of the paper and the collection of money from subscribers.

Subscriber lists were maintained and utilized by both the independent contractors and the Circulation Department. The independent contractors used the lists to determine to whom they should deliver the paper. The Circulation Department periodically checked the lists against newspaper draws to determine that the contractors were getting the proper number of papers. The agreements with the independent contractors provided that the subscriber lists were the property of The News, and were provided by The News to the carriers for delivery purposes only.

Within the City of Saginaw, part-time employees of the paper handled news racks. They were responsible for distribution, collecting the boxes, and bringing in returns. Also, counter sales and mail subscriptions were handled by employees.

The distribution force received their papers in one of two ways. All of the carriers and some of the motor routes had their papers delivered to drop-off points. Some motor route drivers came to The Saginaw News and picked up their papers.

The distribution function at The News reported to the Production Manager who, in turn, reported to the Publisher. The Circulation Department was responsible for all the independent contractors, making sure their draws were adjusted, bills were paid, and that service complaints were passed on to the appropriate contractor. The Circulaton Manager reported directly to the Publisher.

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UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

(Title Omitted in Printing)

FINAL PRETRIAL ORDER

This matter having come before the Court for a pretrial conference pursuant to Fed. R. Civ. P. 16; Donald A. Robinson, having appeared for the plaintiff and Gregory S. Hrebiniak having appeared for defendant; the following Final Pretrial Order is hereby entered:

1. JURISDICTION—This Court has jurisdiction pursuant to 28 U.S.C. § 1346(a)(1).

2. PENDING/CONTEMPLATED MOTIONS

Plaintiff's Motion for Leave to Amend the Complaint to Conform Allegations of Value and Damages to the Evidence Presented at the Trial (as summarized in Item 4 of this Order). Such a motion may be appropriate at the conclusion of the trial, and, if such a motion is appropriate, it will be promptly submitted by Plaintiff at that time.

Defendant contemplates no pretrial motions other than those associated with the testimony of Donald E. Newhouse and Werner Veit as more fully discussed below.

3. STIPULATION OF FACTS

a. Plaintiff, Newark Morning Ledger Co. ("Morning Ledger") is a corporation organized and existing under the laws of the State of New Jersey, having its principal place of business in Newark, New Jersey.

b. Morning Ledger is the successor to The Herald Company ("Herald") which was liquidated by merger into Morning Ledger on June 30, 1987 in a transaction governed by Sections 332 and 334(b)(1) of the Internal Revenue Code of 1954 (the "Code"). For many years prior to June 30, 1987, both corporations were engaged in the business of publishing daily and Sunday newspapers. Morning Ledger continues to be so engaged.

c. Herald was the transferee of the assets of Booth Newspapers, Inc. ("Booth") which was liquidated by merger into Herald on May 31, 1977 in a transaction governed by Sections 332 and 334(b)(2) of the Code as then in effect. Immediately prior to its liquidation, Booth was a Michigan corporation engaged in the publication of the following daily and Sunday newspapers of general circulation in eight Michigan communities: Ann Arbor News, Bay City Times, Flint Journal, Grand Rapids Press, Jackson Citizen Patriot, Kalamazoo Gazette, Muskegon Chronicle and Saginaw News. Booth's wholly owned subsidiary, Parade Publications, Inc. ("Parade"), published *Parade*, a nationally distributed Sunday newspaper supplement.

d. In this action, Morning Ledger has claimed a refund of taxes and deficiency interest collected from it by the Defendant in the following amounts and for the following calendar and taxable years:

Year	Tax	Interest
1977	$5,098,926	$5,355,346
1978	$4,067,383	$4,124,931
1979	$4,018,685	$4,557,838
1980	$3,889,944	$3,626,369

At the time of the preparation of the pretrial order, the trial attorneys for the parties have reached a tentative partial settlement on all of the pending issues except those associated with the depreciation of intangible assets

referred to as "paid subscribers" by Morning Ledger, as is more fully set forth below. The terms of the settlement are memorialized in a written agreement prepared by Morning Ledger and submitted to the Department of Justice. Because of the amounts of the refunds of tax generated by the settlement, the proposal must be reviewed and approved by a hierarchy established by government regulation which may include the Congressional Joint Committee on Taxation. However, the remainder of the pretrial order is being prepared in anticipation of such approval.

e. In total, Herald paid $304,680,145 or $41.44 per share for all of the stock of Booth. Acquisition costs associated with the purchase totalled $2,878,311, giving Herald an adjusted cost basis of $307,558,456 in the Booth stock.

f. Herald's adjusted cost basis in the assets distributed on May 31, 1977 in liquidation of Booth is alleged to be $328,173,154 as agreed upon in the tentative partial settlement described in ¶ 3 d, *supra*.

g. The assets acquired by Herald in the liquidation of Booth were of three types: (1) cash, cash equivalents and other financial assets including securities, accounts and notes receivable and deferred charges and deposits; (2) tangible and intangible assets of the Booth newspaper operations, including land, land improvements, buildings, equipment, furniture, fixtures and vehicles, computer software, going concern and goodwill; and (3) stock of Parade Publications, Inc., a wholly owned subsidiary. In addition, Morning Ledger asserts Herald acquired paid newspaper subscribers as intangible assets. Defendant disputes that paid newspaper subscribers are intangible assets separate and apart from goodwill.

h. On May 31, 1977, the fair market values and adjusted tax bases of certaian of the assets acquired in the liquidation of Booth were as follows (as agreed upon in the tentative partial settlement described in ¶ 3d, *supra*):

Assets	Value	Basis
Cash and Equivalents	$ 15,617,042	$ 15,617,042
Securities	$ 37,249,852	$ 39,134,189
Accounts and Notes Receivable	$ 15,046,899	$ 15,046,899
Master Repurchase Agreements	$ 3,100,000	$ 3,100,000
Deferred Charges and Deposits	$ 323,944	$ 340,311
Inventories	$ 3,435,627	$ 3,609,423
Land	$ 4,658,885	$ 4,894,561
*Land Improvements	$ 1,721,959	$ 1,809,067
*Buildings & Improvements	$ 21,350,237	$ 22,430,269
*Production Equipment	$ 17,109,130	$ 17,974,620
*Computer Hardware	$ 1,300,435	$ 1,366,219
*Furniture and Fixtures	$ 880,775	$ 925,330
*Office Equipment	$ 731,195	$ 768,184
*Autos and Trucks	$ 234,489	$ 246,351
*Computer Software	$ 1,658,000	$ 1,741,872
Stock of Parade	$100,000,000	$105,058,644

* See ¶ 3 1, *infra*.

i. Also included among the assets of Booth distributed to Herald on May 31, 1977 were certain intangible assets, to wit: the going concern value and goodwill of the papers as well as the disputed assets, the paid subscribers of each of the Booth newspapers. On May 31, 1977, the total value and the aggregate tax basis of these assets were $89,578,685 and $94,110,152, respectively, as agreed upon in the tentative partial settlement described in ¶ 3 d, *supra*. The factual determination before the Court is the degree, if any, to which the paid subscribers of the Booth newspapers constitute assets separate and apart from goodwill; and, if so, the value of such assets. To the extent the Court find the paid subscribers of the Booth newspapers have a value separate and apart from goodwill, that value is part of the $89,578,685 and $94,110,152 in total value and aggregate tax basis, respectively, as agreed upon in the tentative partial settlement described in ¶ 3 d, *supra*.

j. The paid subscribers of the Booth newspapers consisted of the customers who had arranged to have one of the Booth newspapers delivered to their homes by mail or

by carrier. On May 31, 1977, the number of paid subscribers of each of the Booth newspapers was as follows:

PAPER	DAILY	SUNDAY
Ann Arbor	37,743	37,121
Bay City	37,337	36,255
Flint	91,366	91,155
Grand Rapids	120,011	106,859
Jackson	35,711	35,632
Kalamazoo	51,481	52,960
Muskegon	41,203	40,609
Saginaw	49,327	48,942

The name and address of each paid subscriber was retained by Booth and/or its circulation employees, agents and/or contractors. The methods of circulation of each of the Booth newspapers is more fully set forth in Morning Ledger's answer to Interrogatory No. 9 which is incorporated in this stipulation.

k. The parties have agreed that, if the Court determines that the paid subscribers of each of the Booth newspapers constitute assets separate and apart from goodwill, and with values which can be ascertained separate and apart from goodwill, and if the Court determines that the paid subscribers of each of the Booth newspapers have useful lives that could be estimated with reasonable accuracy, then the paid subscribers of the Booth newspapers can be amortized or depreciated on a straight-line basis over the following useful lives:

Newspaper	Useful Lives of Daily Subscribers	Useful Lives of Sunday Subscribers
Ann Arbor	14.7	14.7
Bay City	22.2	23.4
Fint	18.3	18.5
Grand Rapids	17.7	21.2
Jackson	17.9	18.9
Kalamazoo	17.0	17.6
Muskegon	18.0	16.2
Saginaw	17.4	18.3

1. For the taxable years 1977-80, the tentative partial settlement recognizes that Herald was entitled to deductions for depreciation or amortization with respect to certain assets acquired in the liquidation of Booth, specifically those assets designated by asterisk in ¶ 3 h, in addition to amounts allowed by the Commissioner of Internal Revenue. Further, during the taxable years 1977, 1978, and 1979, Herald sold certain assets acquired in the liquidation of Booth. Based solely upon the increased cost basis for those assets, as recognized by the tentative partial settlement, as set forth in ¶ 3 h *supra*, Herald's gain on such sales was less than the amounts determined by the Commissioner of Internal Revenue. Finally, solely as a result of the increased deductions and decrease in taxable income as recognized by the tentative partial settlement, Herald's tax liability for the years 1977, 1978, 1979 and 1980 is decreased. Morning Ledger has submitted its calculation as to the amounts of refunds due for 1977 through 1980, and the defendant is verifying the calculations to be finalized only upon final approval of the tentative partial settlement.

m. Morning Ledger timely filed claims for refund asserting a right to the deductions and reduced income claimed in this proceeding.

n. Morning Ledger has not received any credit or refund of all or any part of the taxes set forth in its claims for refund, and at the time of the filing of this suit, the said claims had been denied, or more than six months had passed since they had been filed. The parties agree that a recomputation by the Internal Revenue Service at the conclusion of trial must be performed to verify any amounts due Morning Ledger.

o. Morning Ledger timely filed its complaint in this action.

4. PLAINTIFF'S CONTESTED FACTS

To the extent they constitute contested facts, Morning Ledger intends to prove the following with regard to liability and damages:

a. The paid subscribers of the Booth newspapers were assets with limited useful lives which could be estimated with reasonable accuracy.

b. Morning Ledger's expert, Dr. Gerald J. Glasser, conducted a study of the paid subscribers of the Booth newspapers as of May 1977, and concluded that the remaining lives of those subscribers, and the nature and rate of decay of those subscribers, could be determined with reasonable accuracy.

c. The paid subscribers of the Booth newspapers were assets that could be identified and valued separate and apart from goodwill.

d. Morning Ledger's experts, Larry D. Berkey of Touche Ross & Co. and Roger J. Grabowski of Price Waterhouse & Co. properly determined the fair market values of the paid subscribers of the Booth newspapers as of May 31, 1977. These values are as follows:

1. Valuation Engineering Associates, a business unit of Touche Ross & Co., "Booth Newspapers Fair Market Value Paid Subscribers as of May 31, 1977" dated November 3, 1989:

Newspaper		Fair Market Value
Ann Arbor News	-daily	$ 3,594,000
	-Sunday	517,000
Bay City Times	-daily	4,799,000
	-Sunday	703,000
Flint Journal	-daily	13,119,000
	-Sunday	1,702,000

Newspaper		Fair Market Value
Grand Rapids Press	-daily	12,104,000
	-Sunday	1,679,000
Jackson City Patriot	-daily	4,248,000
	-Sunday	651,000
Kalamazoo Gazette	-daily	6,074,000
	-Sunday	957,000
Muskegon Chronicle	-daily	4,688,000
	-Sunday	604,000
Saginaw News	-daily	5,881,000
	-Sunday	899,000
	Total	$62,219,000

2. Price Waterhouse & Co., "Fair Market Value Study of Paid Newspaper Subscribers to Booth Newspapers as of May 31, 1977" dated October 25, 1989:

Newspaper		Fair Market Value
Ann Arbor News	-daily	$ 3,131,081
	-Sunday	508,484
Bay City Times	-daily	4,870,995
	-Sunday	812,136
Flint Journal	-daily	12,162,206
	-Sunday	2,025,377
Grand Rapids Press	-daily	11,954,936
	-Sunday	1,878,596
Jackson City Patriot	-daily	3,916,261
	-Sunday	660,387
Kalamazoo Gazette	-daily	5,775,600
	-Sunday	1,013,675
Muskegon Chronicle	-daily	4,641,033
	-Sunday	721,501
Saginaw News	-daily	5,730,095
	-Sunday	971,582
	Total	$60,773,945

Based upon the stipulation set forth in ¶ 3 k, *supra*, which was only reached on December 13, 1989, Messrs. Berkey and Grabowski may prepare supplemental tables making revisions to the above

numbers. If such supplemental tables are to be presented in the trial of this matter, they will be promptly provided to defendant's counsel and the Court as soon as they are available.

e. Based on the foregoing fair market values and the determination of the limited useful lives of the paid subscribers of the Booth newspapers, Morning Ledger claims entitlement to additional deductions for depreciation or amortization of those paid subscribers. These figures are currently being computed based upon the stipulation set forth in ¶ 3 k, *supra*. They will be provided to defendant's counsel and the Court as soon as they are available.

f. Based on the deductions set forth in ¶ 4 f, Plaintiff claims refunds in income tax and deficiency interest. These figures are currently being computed based upon the stipulation set forth in ¶ 3 k, *supra*. They will be provided to defendant's counsel and the Court as soon as they are available.

5. DEFENDANT'S CONTESTED FACTS

Defendant intends to prove the following contested facts with regard to liability and damages:

a. There is no asset separate and apart from goodwill entitled "paid newspaper subscribers" and the concept intended to be conveyed by the title "paid newspaper subscribers" has no limited useful life which could be estimated with reasonable accuracy.

b. The only asset traditionally recognized as consistent with plaintiff's concept of "paid newspaper subscribers" is the "subscriber lists" of the subscribers to each of the Booth newspapers. Such lists were in several instances not even the property of nor were they in the possession of the purchased newspapers.

c. To the extent that the "subscriber lists" could be valued at all, Joseph Baniewicz of the Internal Revenue Service has determined a cost replacement value of all the lists to be $2,296,763.

d. To the extent that "subscriber lists" could be valued at all, Shenkin, Kurtz, Baker & Co. has determined a cost value of $1,250,000. However, both Mr. Baniewicz and Mr. Shenkin agree that newspaper subscription lists or "paid newspaper subscribers" have no market value separate and apart from the operation of a newspaper.

e. Newspaper subscription lists or "paid newspaper subscribers" have no determinable useful life.

f. Dr. Shien Perng of the Internal Revenue Service has determined that plaintiff's method of determining the average life is incorrect and that the determination does not arrive at an acceptable useful life.

g. Plaintiff is not entitled to any additional deductions for depreciation or refunds of tax and deficiency interest based on the treatment of "paid subscribers" or subscription lists.

6. PLAINTIFF'S WITNESSES

a. On liability and damages Morning Ledger intends to call the following witnesses who will testify in accordance with the following summaries:

Larry D. Berkey, Touche Ross & Co., Metro Park III, 399 Thornall Street, Edison, NJ 08837, 201-906-9600. Mr. Berkey will testify as to the fair market value of the paid subscribers of the Booth newspapers as of May 31, 1977. The primary points of his testimony are summarized by

Plaintiff's Exhibit No. 1, attached hereto. Based upon the stipulation set forth in ¶ 3 k, *supra*, Mr. Berkey may prepare supplemental tables making revisions to the numbers in the exhibit. If such supplemental tables are to be presented in the trial of this matter, they will be promptly provided to defendant's counsel and the Court as soon as they are available.

Gerald J. Glasser, Ph.D., Statistical Research, Inc., 111 Prospect Street, Westfield, New Jersey 07090, 201-654-4000. Dr. Glasser will testify that the remaining lives of the paid subscribers of the Booth newspapers, and the nature and rate of decay of those subscribers, could be determined with reasonable accuracy as of May 31, 1977. The primary points of his testimony are summarized by Plaintiff's Exhibit No. 2, attached hereto.

Roger J. Grabowski, Price Waterhouse & Co., 200 East Randolph Drive, Chicago, IL 60601, 312-565-1500. Mr. Grabowski will testify as to the fair market value of the paid subscribers of the Booth newspapers as of May 31, 1977. The primary points of his testimony are summarized by Plaintiff's Exhibit No. 3, attached hereto. Based upon the stipulation set forth in ¶ 3 k, *supra*, Mr. Grabowski may prepare supplemental tables making revisions to the numbers in the exhibit. If such supplemental tables are to be presented in the trial of this matter, they will be promptly provided to defendant's counsel and the Court as soon as they are available.

Donald E. Newhouse, Newark Morning Ledger Co., 1 Star Ledger Plaza, Newark, N.J. 07101. 201-877-4115. Mr. Newhouse will testify as to the facts surrounding the acquisition of the Booth Newspapers. He will also testify to the market conditions, business operations, competition, circu-

lation efforts, and subscriber characteristics of the Booth newspapers in particular and the newspaper industry in general. Mr. Newhouse has been deposed in lieu of providing an expert report.

Christine Urban, Ph.D., Urban & Associates, Inc., 26 E. Chestnut Street, Sharon, Massachusetts 02067, 617-784-8500. Dr. Urban will testify as to subscriber characteristics, circulation trends of paid daily newspaper, circulation efforts undertaken by newspapers, and the nature and characteristics of paid and free distribution newspapers with respect to the newspaper industry in general and the Booth newspapers in particular. The primary points of her testimony are summarized by Plaintiff's Exhibit No. 4, attached hereto.

Werner Veit, President, Booth Newspapers, Inc., 155 Michigan, N.W., Grand Rapids, MI 49503, 616-459-3817. Mr. Veit will testify as to the market conditions, business operations, competition, circulation efforts, subscriber characteristics of the Booth Newspapers and efforts made to preserve and enhance goodwill. Mr. Veit has been deposed in lieu of providing an expert report.

b. Defendant objects to the following witnesses for the reasons stated:

Defendant denies that the depositions of Donald E. Newhouse and Werner Veit have been substituted in lieu of providing an expert report and would have the Court characterize the two witnesses as fact witnesses. Their testimony as experts should be excluded in accordance with ¶ 10 of the scheduling order of May 15, 1989.*

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* These witnesses limited to answering hypotheticals set forth on pp. 20 and 21 unless, at least 7 business days before trial, experts' reports submitted.

7. DEFENDANT'S WITNESSES

a. On liability and damages defendant intends to call the following witnesses who will testify in accordance with the following summaries:

Joseph P. Baniewicz, Financial Analyst, Internal Revenue Service, Washington, D.C.; Mr. Baniewicz will testify in accordance with his report on the valuation of the subscription lists of May 31, 1977 and as to the accounting and valuation methods used by plaintiff's experts.

Arthur Shenkin, Shenkin, Kurtz, Baker & Co., Englewood, Colorado; Mr. Shenkin will testify in accordance with his report on the valuation of the subscription lists of May 31, 1977 and as to the accounting and variation methods used by plaintiff's experts.

Dr. Shien Perng, Statistician, Internal Revenue Service, Washington, D.C.; Dr. Perng will testify in accordance with his report on the average remaining life of subscriptions to Booth newspapers.

Donald E. Newhouse, Newark Morning Ledger Co., Newark, New Jersey; Mr. Newhouse will testify on the market conditions, business operations, competition, circulation efforts and subcriber characteristics of the Booth newspapers.

Werner Veit, President, Booth Newspapers, Inc., Grand Rapids, Michigan; Mr. Veit will testify as to the market conditions, business operations, competition, circulation efforts and subscriber characteristics of the Booth newspapers.

b. Morning Ledger objects to the following witnesses for the reasons stated:

Morning Ledger objects to Joseph P. Baniewicz on the basis of Mr. Baniewicz's expertise, and on

the basis of the scope and relevance of his testimony. Morning Ledger intends to explore these issues on voir dire, and respectfully reserves the right to make an objection, if appropriate, at that time.

Morning Ledger objects to Arthur F. Shenkin for the reason that Mr. Shenkin lacks expertise to assist the trier of fact. Morning Ledger further objects to Mr. Shenkin's report for the reason that it contains inadmissible legal argumentation and conclusions. Morning Ledger intends to explore these issues on voir dire, and respectfully reserves the right to make an objection, if appropriate, at that time.*

8. EXPERT WITNESSES

a. Morning Ledger's expert witnesses are:

Larry D. Berkey
Touche Ross & Co.
Metro Park III
399 Thornall Street
Edison, NJ 08837
201-906-9600

Gerald J. Glasser, Ph.D.
Statistical Research, Inc.
111 Prospect Street
Westfield, New Jersey 07090
201-654-4000

Roger J. Grabowski
Price Waterhouse & Co.
200 East Randolph Drive
Chicago, IL 60601
312-565-1500

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* These objections to be made at trial.

Donald E. Newhouse
Newark Morning Ledger Co.
1 Star Ledger Plaza
Newark, N.J. 07101
201-877-4115

Christine D. Urban, Ph.D.
Urban & Associates, Inc.
26 E. Chestnut Street
Sharon, Massachusetts 02067
617-784-8500

Werner Veit
President
Booth Newspapers, Inc.
155 Michigan, N.W.
Grand Rapids, Michigan 49503
616-459-3817

b. Defendant's objection to the qualifications of Morning Ledger's expert witnesses are:

Defendant objects to the classification of fact witnesses, Werner Veit and Donald E. Newhouse, as expert witnesses. Messrs. Veit and Newhouse will testify as to factual matters and have not prepared any expert opinions or reports in accordance with this court's scheduling order.

c. Defendant's expert witnesses are:

Joseph P. Baniewicz
Financial Analyst
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224
202-252-8121

Arthur Shenkin
Shenkin, Kurtz, Baker & Co.
5251 DTC Parkway
Englewood, Colorado 80111
303-796-2600

Dr. Shien Perng
Statistical Methods Group
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224
202-376-0203

d. Morning Ledger's objections to the qualifications of defendant's expert witnesses are:

Morning Ledger objects to Joseph P. Baniewicz on the basis of Mr. Baniewicz's expertise, and on the basis of the scope and relevance of his testimony. Morning Ledger intends to explore these issues on voir dire, and respectfully reserves the right to make an objection, if appropriate, at that time.

Morning Ledger objects to Arthur F. Shenkin for the reason that Mr. Shenkin lacks expertise to assist the trier of fact. Morning Ledger further objects to Mr. Shenkin's report for the reason that it contains inadmissible legal argumentation and conclusions. Morning Ledger intends to explore these issues on voir dire, and respectfully reserves the right to make an objection, if appropriate, at that time.

9. PLAINTIFF'S DEPOSITIONS

On liability and damages Morning Ledger does not intend to read any portion of the depositions into evidence.

10. DEFENDANT'S DEPOSITIONS

a. On liability and damages, defendant does not intend to read any portion of the depositions into evidence unless for unforeseen reasons, a witness is unable to testify at trial.

b. Morning Ledger reserves the right to object to any portion of such deposition testimony at the

time it is offered depending on the circumstances upon which it is offered.

11. PLAINTIFF'S EXHIBITS

(Except for exhibits the need for which could not reasonably have been foreseen or which are used solely for impeachment purposes, only the exhibits set forth on the exhibit list attached hereto may be introduced at trial. Any objection to an exhibit, and the reason for said objection, must be set forth below or it shall be deemed waived. All parties hereby agree that it will not be necessary to bring in the custodian of any exhibit as to which no such objection is made.)

a. Morning Ledger intends to introduce into evidence the exhibits listed on the attached exhibit list:

1. Valuation Engineering Assoc., a business unit of Touche Ross & Co., "Booth Newspapers Fair Market Value Paid Subscribers as of May 31, 1977" dated November 3, 1989
2. Statistical Research, Inc., "Report on the Average Remaining Life of Subscriptions to Booth Newspapers" dated March 1978
3. Price Waterhouse & Co., "Fair Market Value Study of Paid Newspaper Subscribers to Booth Newspapers as of May 31, 1977" dated October 25, 1989
4. Urban & Associates, Inc., "An Overview of Paid Daily Newspaper Circulation Trends"
5. The Columbia Flier, v. 8, no. 50, dated June 2, 1977. (Columbia, MD).
6. The Reader, v. 6, no. 34, dated May 27, 1977. (Chicago, IL).

7. The Columbia Flier, v. 21, no. 25, dated November 30, 1989. (Columbia, MD).
8. The Reader, v. 19, no. 11, dated December 8, 1989. (Chicago, IL).

b. Defendant does not object to the authenticity of any of Morning Ledger's exhibits; however, defendant reserves the right to object to the exhibits enumerated as 5-8 on grounds of relevancy and admissibility depending upon the circumstances under which they are offered into evidence.

12. DEFENDANT'S EXHIBITS

a. Defendant intends to introduce into evidence the exhibits listed on the attached exhibit list:

1. The Fair Market Value of the Booth Newspapers Inc's. Subscription Lists as of May 31, 1977, by Joseph Baniewicz.
2. Shenkin, Kurtz, Baker & Co's. Report in Newark Morning Ledger Co. v. United States.
3. Statistical Methods Group's Comments on Report of the Average Remaining Life of Subscriptions to Booth Newspapers.
4. Booth Newspapers, Inc. Fair Market Value by Arthur D. Little Valuation, Inc., dated December 10, 1985.
5. Fair Market Value Study of Booth Newspapers, Inc. for Herald Company as of May 31, 1977, by American Valuation Consultants, dated May 4, 1979.
6. Selected copies of publications listed in the plaintiff's Answer to Interrogatory No. 12 propounded by defendant.
7. Answer to Interrogatory No. 11 propounded to plaintiff by the defendant.

8. Audit Bureau of Circulation Audit Reports on each Booth newspaper.

9. Research Reports prepared by Goldfarb Consultants Limited for the Booth newspapers.

10. Market studies conducted by Market Opinion Research for the Booth newspapers.

11. A market study of the Jackson City Patriot by Gendinning and Associates.

12. Two market studies by Reichman Research, Inc. on the Grand Rapids Press.

b. Morning Ledger does not object to the authenticity of any of defendant's exhibits; however, Morning Ledger reserves the right to object to the exhibits enumerated as 3, 4, 5, 6, and 8-12 on grounds of relevancy and admissibility depending upon the circumstances under which they are offered into evidence.

13. PLAINTIFF'S LEGAL ISSUES

To the extent they constitute legal issues, Morning Ledger intends to address the following:

a. Are the paid subscribers of each Booth newspaper assets which can be identified and valued separate and apart from goodwill?

b. Do the paid subscribers of the Booth newspapers have limited useful lives which can be estimated with reasonable accuracy?

14. DEFENDANT'S LEGAL ISSUES

a. Is the asset termed by the plaintiff "paid subscribers" an asset which is separate and apart from goodwill.

b. Is the asset termed by plaintiff "paid subscribers" an asset which can be reasonably and accurately valued.

c. Does the asset termed by the plaintiff "paid subscribers" have a useful life which can be estimated with reasonable accuracy.

15. MISCELLANEOUS

None.

16. JURY TRIALS—NOT APPLICABLE

17. NON-JURY TRIALS—Not later than January 24, 1990

a. Each side shall submit to the judge and opposing counsel a trial brief or memorandum in accordance with General Rule 27 with citation to authorities and arguments in support of its position on all disputed issues of law,* In the event a brief shall not be filed, the delinquent party's complaint or defense may be stricken.

b. Morning Ledger intends to put the following hypothetical questions to Mr. Newhouse and/or Mr. Veit and/or Dr. Urban on direct examination:

1. If a [Booth] newspaper were to choose to become a free distribution newspaper, and it wanted to maintain its level of advertising revenues, what actions would be taken to accomplish that goal?

2. If [a Booth newspaper] on May 31, 1977 were given the opportunity to purchase a set of seasoned subscribers with subscriber characteristics identical to the actual subscribers of the [Booth newspaper] on May 31, 1977, for a price in the neighborhood of $150 per seasoned subscriber, would you have made that purchase?

c. Defendant intends to put the following hypothetical questions to the following expert witnesses on

* as well proposed findings of fact and conclusions of law.

direct examination: None. Defendant, however, reserves the right to submit hypothetical questions at the time of the submission of brief in accordance with ¶ 17 of the Final Pretrial Order.

18. TRIAL COUNSEL

a. For the plaintiff:

Donald A. Robinson
Bernard J. Long, Jr.
Albert H. Turkus

b. For the defendant:

Gregory S. Hrebiniak

19. BIFURCATION

The issues of liability and damages SHALL NOT be tried separately.

20. ESTIMATED LENGTH OF TRIAL

5 days for liability and damages.

AMENDMENTS TO THIS PRETRIAL ORDER WILL NOT BE PERMITTED UNLESS THE COURT DETERMINES THAT MANIFEST INJUSTICE WOULD RESULT IF THE AMENDMENT IS DISALLOWED. THE COURT MAY FROM TIME TO TIME SCHEDULE CONFERENCES AS MAY BE REQUIRED EITHER ON ITS OWN MOTION OR AT THE REQUEST OF COUNSEL.

DOW, LOHNES & ALBERTSON
Attorneys for Plaintiff
1255 23rd Street, N.W.
Washington, D.C. 20037

By: /s/ Bernard J. Long
BERNARD J. LONG, JR.

By: /s/ Albert H. Turkus
ALBERT H. TURKUS

/s/ Donald A. Robinson
DONALD A. ROBINSON
Attorney for Plaintiff
Robinson, Wayne & LaSala
One Gateway Center
Newark, New Jersey 07102
(201) 621-7900

/s/ Gregory S. Hrebiniak
GREGORY S. HREBINIAK
Attorney for Defendant
U.S. Department of Justice
Tax Division
555 4th Street, N.W.
Room 6810
Washington, D.C. 20001
(202) 724-6346

/s/ Ronald J. Hedges
RONALD J. HEDGES
United States Magistrate

Dated: 12/18/89

(Attachments Omitted in Printing)

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

(Title Omitted in Printing)

[Entered Feb. 1, 1990]

AMENDMENTS TO STIPULATIONS

The Stipulations of Fact set forth in ¶ 3 of the Final Pre-Trial Order are hereby amended as follows:

1. Paragraph 3 e is modified by inserting the following sentence at the beginning of the paragraph: "Herald purchased all the outstanding stock of Booth during the period beginning February 12, 1976 and ending November 5, 1976."

2. Paragraph 3 h is amended to reflect that the adjusted basis for Deferred Charges and Deposits as of May 31, 1977 was $340,331 (in accordance with the letter agreement dated October 12, 1989, rather than $340,311 as misstated in the original ¶ 3 h of the Final Pre-Trial Order).

3. Paragraph 3 i is modified by inserting the following text at the end of ¶ 3 i: "The aggregate fair market value of the going concern value and the goodwill of the Booth newspapers shall be the difference between $89,578,685 and the fair market value of the paid subscribers of the Booth newspapers, as determined by this Court. The adjusted tax basis of the paid subscribers of the Booth newspapers shall be the same proportion of $94,110,152 as the fair market value of the paid subscribers is of $89,578,685. The aggregate adjusted tax

basis of the going concern value and the goodwill of the Booth newspapers shall be the difference between $94,110,152 and the adjusted tax basis of the paid subscribers of the Booth newspapers."

4. Paragraph 3 j is amended to reflect that the number of Sunday paid subscribers to the Ann Arbor News was 37,122 (instead of 37,121 as misstated in ¶ 3 j of the original Final Pre-Trial Order).

/s/ Donald A. Robinson
DONALD A. ROBINSON
Robinson, Wayne & LaSala
One Gateway Center
Newark, New Jersey 07102
(201) 621-7900

/s/ Albert H. Turkus
ALBERT H. TURKUS
Dow, Lohnes & Albertson
1255 23rd Street, N.W.
Washington, D.C. 20037
(202) 857-2500
Attorneys for Plaintiff

/s/ Gregory S. Hrebiniak
GREGORY S. HREBINIAK
U.S. Department of Justice
Tax Division
555 4th Street, N.W.
Room 6810
Washington, D.C. 20001
(202) 724-6346
Attorney for Defendant

/s/ Ronald J. Hedges
RONALD J. HEDGES
United States Magistrate

DATED: 1/24/90

PLAINTIFF'S EXHIBIT 1

[LOGO] Touche Ross

Booth Newspapers
Fair Market Value
Paid Subscribers
As of May 31, 1977

Valuation Engineering Associates

Metro Park Ill
399 Thornall Street
Edison, NJ 08837
Telephone, 201 906-9600
Telecopier, 201 906-9660

January 31, 1990

Mr. Bernard J. Long
Dow Lohnes & Albertson
1255 Twenty-third Street
Washington, DC 20037

Dear Mr. Long:

Pursuant to your authorization, we conducted a fair market value study of the paid subscribers of the Booth Newspapers, Inc. as of May 31, 1977.

For purposes of this appraisal, we define the term fair market value as "the price which property will bring when it is offered for sale by one who is willing, but is not obligated to sell it and is bought by one who is willing or desires to purchase, but is not compelled to do so." We valued the assets using value-in-use as the premise of value, which measures the assets' worth as part of a continuing business.

Based upon our appraisal procedures, we conclude the fair market values of the paid subscribers of the newspapers of Booth Newspapers, Inc., to be as follows:

Paid Subscribers—Life and Value

Groups of Subscribers	Number of Subscribers	Fair Market Value	Average Remaining Useful Life
Ann Arbor News—Daily	37,743	$ 3,966,000	14.7
Ann Arbor News—Sunday	37,122	557,000	14.7
Bay City Times—Daily	37,337	5,146,000	22.2
Bay City Times—Sunday	36,255	737,000	23.4
Flint Journal—Daily	91,366	14,392,000	18.3
Flint Journal—Sunday	91,155	1,810,000	18.5
Grand Rapids Press—Daily	120,011	13,250,000	17.7
Grand Rapids Press—Sunday	106,859	1,761,000	21.2
Jackson Citizen Patriot —Daily	35,711	4,622,000	17.9
Jackson Citizen Patriot —Sunday	35,632	688,000	18.9
Kalamazoo Gazette—Daily	51,481	6,655,000	17.0
Kalamazoo Gazette—Sunday	52,960	1,021,000	17.6
Muskegon Chronicle—Daily	41,203	5,116,000	18.0
Muskegon Chronicle—Sunday	40,609	651,000	16.2
Saginaw News—Daily	49,327	6,446,000	17.4
Saginaw News—Sunday	48,942	955,000	18.3
Total		$67,773,000	

• • • •

Paid Subscribers Valuation

We identified sixteen groups of paid subscribers as intangible assets that support the operations of Booth Newspapers.

The subscriber groups include the daily and Sunday subscribers for the following newspapers: *The Ann Arbor News*, *The Bay City Times*, *The Flint Journal*, *The Grand Rapids Press*, *The Jackson Citizen Patriot*, *The Kalamazoo Gazette*, *The Muskegon Chronicle*, and *The Saginaw News*.

To determine the value of the paid subscribers, we projected the future retirement activity based on the current paid subscribers. To estimate the future retirement activity of the paid subscribers, we relied upon subscriber survivor information contained in a report issued by Statistical Research, Inc. (SRI) as modified by the stipulation of the parties. The SRI report provided a mortality table delineating the percent of the original population that was still active at each annual interval for the paid subscribers. These mortality tables define a survivor curve for the subscribers of each of the sixteen subscriber groups.

We used the retirement activity represented by the SRI survivor curves, as modified by the stipulation, as a forecast for future retirement activity. Combining the age distribution of the existing subscribers, as taken from the SRI report, the anticipated future retirement activity, and the current level of net revenues, we forecast the future cash flows that would be derived from these subscriber bases. We discounted these cash flows to generate the net present value for each group of subscribers.

Discounted Cash Flow Approach

To determine the value of the paid subscribers of the Booth newspapers, we used the discounted cash flow approach. First we performed a pro forma analysis of the paid subscribers to estimate cash flow. Cash flow per subscriber is derived by using the following analysis:

Revenue per subscriber per day (subscription price less cost of delivery)

Less: (Cost to collect per day)

Equals: (Daily pretax cash flow attributable to each subscriber)

This definition is based upon the fact that a paid subscriber paper and a free distribution newspaper have the same categories of revenues and expenses, with the excep-

tion of the subscriber revenue and the cost to collect that revenue. Therefore the subscriber revenue less the cost to collect is the net cash flow attributable to the existence of each paid subscriber.

The results of the above described analysis were presented in a report prepared by American Valuation Consultants, Inc. and incorporated into a later report by Price Waterhouse. We accepted those values as being accurate and summarized them in Table I-1.

Table I-1

Daily Net Subscription Revenue Per Subscriber

Group of Subscribers	Cash Flow/Day/Paid Subscriber
Ann Arbor News—Daily	$0.0953
Ann Arbor News—Sunday	0.0952
Bay City Times—Daily	0.1079
Bay City Times—Sunday	0.1075
Flint Journal—Daily	0.1193
Flint Journal—Sunday	0.1143
Grand Rapids Press—Daily	0.0924
Grand Rapids Press—Sunday	0.0913
Jackson Citizen Patriot—Daily	0.1054
Jackson Citizen Patriot—Sunday	0.1054
Kalamazoo Gazette—Daily	0.1073
Kalamazoo Gazette—Sunday	0.1076
Muskegon Chronicle—Daily	0.1006
Muskegon Chronicle—Sunday	0.1005
Saginaw News—Daily	0.1083
Saginaw News—Sunday	0.1082

To project the future annual cash flow associated with each subscriber, we multiplied the daily cash flow from net subscription revenue per subscriber by the number of days per year for each edition of each paper. We assumed that all daily papers were published six days per week, 52 weeks per year and that the Sunday editions comprised 52 editions annually. Moreover, we projected that the subscription rates would experience an inflationary

growth rate of 4 percent annually, based upon information published in the 1976 edition of *Predicasts*. Then we applied the retirement rates from the previously described survivor curves to the cash flow forecast. The product of the base year cash flow, times the growth rate, times the retirement rate yielded the expected future annual cash flows from existing subscribers. We then discounted the annual cash flows to produce a present value which represents the price a prudent investor would pay for the existing paid subscribers of the Booth newspapers as of May 31, 1977.

Tax Rate

The current federal statutory income tax rate, at the date of valuation, is 46 percent of pretax income. The Michigan activity tax is 2.35 of pretax income. Thus, we projected that the tax rate of Booth Newspapers, Inc., would be 47.3 percent of pretax income.

Discount Rate

As we detail in Exhibit I, we calculated the appropriate discount rate to be 15 percent.

Conclusion of Value

Based upon our analysis, we conclude that the fair market value of the paid subscribers is $67,773,000. We present the results of our pro forma discounted cash flow analysis for each group of paid subscribers in Exhibit II. We summarize the results of our cash flow analysis and determination of average remaining useful life for each group of paid subscribers in Table I-2.

Table I-2

Paid Subscribers—Life and Value

Groups of Subscribers	Number of Subscribers	Fair Market Value	Average Remaining Useful Life
Ann Arbor News—Daily	37,743	$ 3,966,000	14.7
Ann Arbor News—Sunday	37,122	557,000	14.7
Bay City Times—Daily	37,337	5,146,000	22.2
Bay City Times—Sunday	36,255	737,000	23.4
Flint Journal—Daily	91,366	14,392,000	18.3
Flint Journal—Sunday	91,155	1,810,000	18.5
Grand Rapids Press—Daily	120,011	13,250,000	17.7
Grand Rapids Press—Sunday	106,859	1,761,000	21.2
Jackson Citizen Patriot —Daily	35,711	4,622,000	17.9
Jackson Citizen Patriot —Sunday	35,632	688,000	18.9
Kalamazoo Gazette—Daily	51,481	6,655,000	17.0
Kalamazoo Gazette—Sunday	52,960	1,021,000	17.6
Muskegon Chronicle—Daily	41,203	5,116,000	18.0
Muskegon Chronicle—Sunday	40,609	651,000	16.2
Saginaw News—Daily	49,327	6,446,000	17.4
Saginaw News—Sunday	48,942	955,000	18.3
Total		$67,773,000	

Based upon our analysis and that of Statistical Research, Inc., we were able to determine both lives and values for Booth Newspapers' paid subscribers which are distinctly different from goodwill. Treasury regulations provide for amortization of intangible capital assets:

> "If an intangible asset is known from experience or other factors to be of use in the business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy, such an asset may be the subject of a depreciation allowance."

In our opinion there is no doubt that paid subscribers do produce income and for a limited period of time. We have, in other circumstances, determined that limited

period of time for subscribers to other newspapers and publications. In this case the parties have entered into a stipulation regarding that limited period. Therefore, based upon the SRI report, the stipulation, and our analysis, it is our opinion that the value of the paid subscribers and their useful life have been determined with reasonable accuracy and as such the paid subscribers are separate from goodwill.

• • • •

PLAINTIFF'S EXHIBIT 2

REPORT ON THE AVERAGE REMAINING LIFE OF SUBSCRIPTIONS TO BOOTH NEWSPAPERS

STATISTICAL
RESEARCH, INC.
111 Prospect Street
Westfield, New Jersey 07090
201-654-4000

March 1978

REPORT ON THE AVERAGE REMAINING LIFE OF SUBSCRIPTIONS TO BOOTH NEWSPAPERS

Prepared by
Statistical Research, Inc.

Summary

This is a report on the average remaining life of subscriptions to the following Booth newspapers:

Ann Arbor News
Bay City Times
Flint Journal
Grand Rapids Press
Jackson Citizen Patriot
Kalamazoo Gazette
Muskegon Chronicle
Saginaw News

The results are based on statistical analyses of data collected in surveys of subscribers to the newspapers.

These surveys were conducted by Statistical Research, Inc. (SRI) during the period November 1977-February 1978. They involved selecting a probability sample of subscribers, drawn from subscriber lists submitted by the newspapers. Selected subscribers were then contacted by telephone, personal delivery, or mail, and interviewed primarily to determine the length of time they had subcribed.

For purposes of the study, a subscription has been defined as continuous delivery to a particular address either by carrier or, in a few cases, by mail. The specific question asked of subscribers was, "For how long has the (e.g.) Ann Arbor News been delivered to your present address?"

Data collected in the surveys were used to construct, by appropriate statistical methods, mortality tables for subscriptions to each newspaper. Separate tables were prepared for daily and Sunday subscriptions, though there is considerable overlap because most subscribers have the paper delivered both daily and Sunday. Mortality experience tables for each newspaper are included in the following section.

Each mortality table is based solely on the experience of the paper it refers to. Thus, each table has been constructed independently of the others, based on relevant data, and each has its own unique actuarial characteristics.

In some tables, experience indicates that the expected (remaining) life of a subscription decreases slightly over time, thereby demonstrating some aging factor. In other tables, experience indicates that the remaining life increases slightly over time, thereby demonstrating some wear-in or "infant" mortality factor.

However, all of the tables indicate that the remaining life of a subscription does not vary much with the age of the subscription. This fact is not surprising and is consistent with a large body of applicable statistical theory.

Mortality tables of subscriptions, in turn, permit calculation of the average remaining life of subscriptions to each newspaper. These results are as follows:

Newspaper	Daily	Sunday
Ann Arbor News	9.8	9.8
Bay City Times	14.8	15.6
Flint Journal	12.2	12.3
Grand Rapids Press	11.8	14.1
Jackson Citizen Patriot	11.9	12.6
Kalamazoo Gazette	11.3	11.7
Muskegon Chronicle	12.0	10.8
Saginaw News	11.6	12.2

The study also provides the basis for determining the number of daily and Sunday subscriptions to each newspaper. These results are as follows:

Newspaper	Daily	Sunday
Ann Arbor News	37,743	37,122
Bay City Times	37,337	36,255
Flint Journal	91,366	91,155
Grand Rapids Press	120,011	106,859
Jackson Citizen Patriot	35,711	35,632
Kalamazoo Gazette	51,481	52,960
Muskegon Chronicle	41,203	40,609
Saginaw News	49,327	48,942

Subsequent sections of this report describe (a) statistical methods used in developing mortality experience tables, (b) determination of number of daily and Sunday subscriptions to each newspaper, and (c) procedures employed in conducting the surveys of subscribers.

PLAINTIFF'S EXHIBIT 3

FAIR MARKET VALUE STUDY OF
PAID NEWSPAPER SUBSCRIBERS
TO
BOOTH NEWSPAPERS
AS OF
MAY 31, 1977

Price Waterhouse [LOGO]

Price Waterhouse

January 31, 1990

Newark Morning Ledger Company
c/o Paul Scherer
Paul Scherer & Company,
Certified Public Accountants
330 Madison Avenue
New York, New York 10017

Dear Mr. Scherer:

This report sets forth our analysis of the Fair Market Values of the paid newspaper subscribers to the eight newspapers published by Booth Newspapers, Inc., ("Booth") as of May 31, 1977.

Fair Market Value is defined as the price at which property would change hands between a willing buyer and a wililng seller, when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both having reasonable knowledge of relevant facts. For purposes of this engagement, the Fair Market Values of the subject assets were analyzed assuming the newspaper operations of Booth were continued as an ongoing business.

In performing our work, we took such steps as we considered appropriate to arrive at our conclusions of values including the following:

- Visits to the operations of each of the Booth newspapers:

  The Ann Arbor News, Ann Arbor, Michigan
  The Bay City Times, Bay City, Michigan
  The Flint Journal, Flint, Michigan
  The Grand Rapids Press, Grand Rapids, Michigan
  Jackson City Patriot, Jackson, Michigan
  Kalamazoo Gazette, Kalamozoo, Michigan

The Muskegon Chronicle, Muskegon, Michigan
The Saginaw News, Saginaw, Michigan

and to the corporate headquarters and computer center in Ann Arbor, Michigan;

- Discussions with newspaper management, both operating and financial, concerning the markets within which each newspaper operates, the operations of each newspaper, and the historic financial results and strategic outlook for each newspaper;
- Research into the newspaper industry at an economy-wide level to study the development of the industry as a whole and research into the economic and competitive environment in which each of the newspapers operates;
- Analysis of the paid subscribers (not including single copy sales) to Booth newspapers as of May 31, 1977.

In performing our valuation, we used and relied on the accuracy and completeness of various historical and prospective information provided to us or contained in public sources. We have also incorporated certain data and analysis developed by and under the direction of Roger J. Grabowski, National Director of Valuation Services of Price Waterhouse and author of this report, during the period of his employment by American Valuation Consultants, Inc., as contained in the report "Fair Market Value Study of Booth Newspapers, Inc., for The Herald Company as of May 31, 1977," prepared by American Valuation Consultants, Inc. dated May 4, 1979.

We also read "Report on the Average Remaining Life of Subscriptions to Booth Newspapers" prepared by Statistical Research, Inc., dated March 1978; we used the results contained therein in our valuation as revised by stipulation of the parties. However, we have not been engaged to compile, review, or examine such information or these reports in accordance with standards established

by the American Institute of Certified Public Accountants and, accordingly, do not express our opinion or any form of assurance thereon.

* * * *

II. *PAID NEWSPAPER SUBSCRIBERS*

We determined the appropriate method of valuing the paid subscribers (excluding single copy sales) is to capitalize the cash flows expected to be received from the paid subscriber (income approach to value). We also considered the cost approach but concluded that it is too difficult to estimate accurately the full replacement cost of a "seasoned" group of paid subscribers (i.e., a group of paid subscribers with the same remaining life characteristics as the paid subscribers to the Booth newspapers at the valuation date).

A cost approach is inappropriate because the expenditures observed at each Booth newspaper for outside sales organizations to solicit subscribers are simply the cost to attract a new, marginal subscriber. It is a well-recognized fact that new subscribers as a group have a shorter expected "life" (subscription period) than a group of seasoned paid subscribers. In fact; a number of new subscribers must be signed to obtain even one who will have a useful life comparable to that of a seasoned subscriber.

In addition, a valuation based upon the cost approach is only hypothetical because these seasoned subscribers are not available for sale other than in connection with the newspaper to which they subscribe. While a cost approach estimate may be a useful method of corroborating a valuation based on estimated cash flows, a prudent investor will measure the benefits of ownership based on the capitalized cash flow expected from ownership of the asset.

In capitalizing the cash flows, the prudent investor determines Fair Market Value according to the value of the cash flows that an asset can be expected to generate over its useful life. In using this approach, we first project the annual cash flows that an asset will generate over its useful life and then convert these cash flows into a present value equivalent through a process known as discounting.

The discounting process uses a rate of return which accounts for (1) the relative risk of not realizing the estimated cash flows and (2) the time value of money. We then project the residual value of the asset at the end of its useful life and convert it to its present value equivalent. Often that residual value is zero. The Fair Market Value of an asset is equal to the sum of the present value of the projected cash flows and the present value of the residual value.

The following discussion explains the steps that we used in calculating the cash flows attributable to the paid subscribers:

1. *Remaining Useful Life*

   We were provided with a report performed by Statistical Research, Inc., which provided a survivor table delineating the percent of the original paid subscribers that could be expected to remain subscribers at each future year-end. We used the results of that study in our valuation as revised by stipulation of the parties.

2. *Marginal Revenue Per Newspaper From Each Paid Subscriber*

   The prudent investor must calculate the additional revenue that each newspaper will receive from each paid subscriber. The first step was to calculate the number of publications each subscriber received during the year. Each daily newspaper was received at

least 312 days per year by the subscribers; each Sunday newspaper was received at least 52 days per year by the subscribers.

The next step was to determine the revenue the newspaper receives from each paid subscriber. The revenue per subscription was calculated using the actual revenue which each newspaper receives (based on the posted subscription price for a combined daily and Sunday subscription which is the lowest posted priced subscription) minus the collection costs and the salaries and benefits of the personnel who work in the collections area. No costs other than collection costs were subtracted from daily revenue received by each newspaper because no other marginal expenses were associated with the subscription revenue.

The prime target market of any newspaper is the retail advertising account, as advertisers' revenues normally generate 60% to 75% of a newspaper's total revenue and averaged 77% of the Booth newspaper operations revenue for the years 1973 through 1976. Advertising rates are dependent upon circulation. However, advertising revenue will exist even wtihout paid subscribers. Some newspapers are given away to establish the circulation necessary to get a guaranteed advertising rate.

In calculating the marginal revenues expected from the paid subscribers, we were conservative in that we did not project any future increases in the marginal revenue per subscriber.

The calculations of revenue per subscriber and collection costs were performed by American Valuation Consultants, Inc., and the results are contained in its report. Pertinent excerpts from the American Valuation Consultants, Inc., reports are contained in Appendix I. We used the results of its work as reported therein in our valuation. These calculations are summarized the the following table:

TABLE 1

As of May 31, 1977

	Number of Subscribers Daily	Sunday	(1) Average Revenue Per Subscriber Per Day	Total Cost To Collect Per Day
Ann Arbor News	37,744	37,121	.104679	$401.41
Bay City Times	37,338	36,255	.120918	487.52
Flint Journal	91,366	91,155	.122275	727.11
Grand Rapids Press	120,011	106,859	.100698	999.05
Jackson Citizen Patriot	35,710	35,634	.115005	343.98
Kalamazoo Gazette	51,481	52,958	.116400	466.85
Muskegon Chronicle	41,204	40,609	.108207	311.97
Saginaw News	49,328	48,941	.118900	523.06

3. *Total After-Tax Marginal Revenue From the Paid Subscribers*

To determine the total marginal revenue from the paid subscribers in any year, we multiplied the average number of subscribers subscribing during each year (average of the subscribers at the beginning and end of each year) times the number of days the subscribers receive the newspapers and then multiplied by the average revenue per subscriber per day. We then subtracted the total cost to collect the revenue and adjusted for income taxes using a rate of 50% for the combined federal and effective state income taxes.

4. *Fair Market Value of Cash Flows*

We computed the present values of the resulting after-tax cash flows. The calculations are shown in Exhibit I. We used a 13% after-tax rate of return in our calculations. Exhibit II contains the explanation and calculation of the rate of return.

The Fair Market Value (FMV) (that is, the price at which the asset can be expected to change hands between the willing buyer and a willing seller) can be calculated by adding the present value of the asset's

after-tax cash flows before amortization plus the present value of the tax savings which will be realized due to amortization of the asset. The following relation is used to calculate the value of the asset:

FMV = Present Value of After-Tax Cash Flow before Amortization of the Paid Subscribers

Plus

Present Value of Income Tax Savings due to Amortization of the Paid Subscribers

= Present Value of After-Tax Cash Flow before Amortization of the Paid Subscribers

Plus

FMV

Times: AF

Times: Income Tax Rate (50%)

Where:

FMV = Total Fair Market Value of the Paid Subscribers

AF = Amortization Factor

= Sum of ((1/Useful life as stipulated) * (Present Value Factor year i))

= Present Value of amortization per dollar of FMV

To calculate the Fair Market Value using the above formula, one solves algebraically the formula for the "unknown" "FMV." We used the straight-line method to calculate the amortization of the paid subscribers.

In applying the straight-line method, each year's amortization percentage is calculated by dividing one (i.e., "1") by the Useful Life as stipulated. We calculated the Amortization Factor used in the above formula as the sum of the present value of the amortization percentages (that is, amortization percentage for each year times the appropriate present value factor for that year summed for all years of the Useful Life as stipulated).

Based on our investigation and analysis, we conclude that the total Fair Market Value of the existing paid newspaper subscribers as of May 31, 1977, was:

SIXTY MILLION FOUR HUNDRED
SEVENTY THOUSAND DOLLARS

($60,470,000)

Revised Table 2 summarizes the results for each newspaper.

TABLE 2

Newspaper		No. of Subscribers	Useful Lives[1]	FMV Per Subscriber	Total FMV[2]
Ann Arbor News	—daily	37,744	14.7	$ 86.54	$ 3,266,366
	—Sunday	37,121	14.7	14.29	530,533
Bay City Times	—daily	37,338	22.2	124.10	4,633,483
	—Sunday	36,255	23.4	21.11	765,263
Flint Journal	—daily	91,366	18.3	131.83	12,044,440
	—Sunday	91,155	18.5	21.96	2,001,541
Grand Rapids Press	—daily	120,011	17.7	99.58	11,951,244
	—Sunday	106,859	21.2	16.93	1,809,092
Jackson City Patriot	—daily	35,710	17.9	109.52	3,910,854
	—Sunday	35,634	18.9	18.29	651,854
Kalamazoo Gazette	—daily	51,481	17.0	113.17	5,826,130
	—Sunday	52,958	17.6	19.16	1,014,808
Muskegon Chronicle	—daily	41,204	18.0	112.08	4,618,250
	—Sunday	40,609	16.2	18.09	734,611
Saginaw News	—daily	49,328	17.4	116.53	5,748,166
	—Sunday	48,941	18.3	19.70	964,162
					$60,470,896
				Say to:	$60,470,000

(1) Based on stipulation of parties

(2) Number of Subscribers X FMV per subscriber

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PLAINTIFF'S EXHIBIT 4

AN OVERVIEW OF PAID DAILY NEWSPAPER CIRCULATION TRENDS

Urban & Associates, Inc.
Sharon, Massachusetts

The Importance of Subscribers

A paid circulation newspaper operates in two separate economic markets: competing with a wide range of other print and electronic media for revenues from both readers and advertisers.

A newspaper's subscribers—i.e.: the customers who pay to have the paper delivered to their homes or businesses by hand delivery or by mail—are a direct source of substantial revenue to the newspaper, usually representing between 20-30% of the total revenues of the business. Moreover, the number of paying subscribers to a newspaper at a particular point in time is significant to advertisers because it reflects the community's acceptance and readership of the paper at that time, due to the paper's ability to meet market needs through provision of a quality editorial product and good circulation service. (The reports published by the Audit Bureau of Circulations are a widely-accepted measure of a newspaper's circulation.)

Given the importance of paid subscribers, daily newspapers are continuously involved in efforts to sell subscriptions and build circulation. These circulation numbers are only meaningful, of course, in relation to the number of households in the market, with market penetration (i.e.: the proportion of households reached by the newspaper) being the most important indicator of how well the newspaper is doing. Even if a newspaper's circulation remains stable or grows slightly, then, its ability to generate revenues is threatened if the rate of household formation in its market exceeds that growth.

The stagnant circulation and declining market penetration trends facing most paid daily newspapers across the country threaten both subscription and advertising revenues, because there are many viable competitors willing and able to fulfill both reader and advertiser demand. Thus, newspapers expend considerable efforts to maintain and develop their circulation, in recognition of the fact

that failing to do so would eventually result in failure of their business.

Trends in Newspaper Circulation and Readership

Even a cursory examination of long-term trend data from the newspaper industry (see exhibits on the following pages) suggests that over the past twenty years, there has been a continuous decline in both the proportion of households that **subscribe** to a newspaper as well as the number of U.S. adults that **read** a newspaper at all. These downward trends have occurred **despite** newspapers' intensive efforts to increase circulation.

The revenue significance of a diminishment in audience size and market penetration is clear: not only are newspapers across the country worried about these trends, they have considered them a potent mandate requiring significant and on-going investments in building circulation that not only **should** but **must** be made to preserve their ability to do business.

* * * *

Industry Reactions to Declining Circulation

With its paid subscribers at risk, the newspaper industry has paid considerable and deserved attention to the issue of declining readership and newspaper subscriptions. Over the past five to ten years, for instance, it would be hard to find any trade publication, any industry meeting or conference program, or any individual newspaper's strategic plan that did not address either **an explanation** of the readership problem or the **investments required** to solve it.

In general, most U.S. paid daily newspapers have made (and continue to make) substantial investments in:

1) **circulation sales programs** to attract new readers and subscribers to the newspaper (with commonly-

used techniques including telephone solicitation campaigns, door-to-door sales, reduced price offers, distribution of free samples of the newspaper, carrier sales incentives and contests, direct mail solicitations, etc.)

2) **subscriber retention programs** to hold existing subscribers who are about to cancel their subscriptions (encompassing efforts to improve present subscribers' satisfaction with the quality of home-delivery service provided as well)

3) **market research studies** to identify what non-readers and infrequent readers want in their newspapers, and track the success of sales and retention programs, and

4) **product improvements** to attract and hold readers, including not only the addition of new content (e.g.: new sections, more space in the paper to enhance news coverage, purchase of new syndicated features, etc.) but also improvements in packaging (e.g.: significant redesigns, additions of color and graphics to the paper, etc.) to help the newspaper be a more valuable and easier to use source of news and information to its readers.

Since the early part of the 1970's, most newspapers across the U.S. have made concerted efforts in some or all of these areas, especially in circulation sales programs. Many, for instance, invested heavily in solicitation campaigns that offered premiums and half-price offers to attract new circulation, only to see many new subscribers cancel their subscription when the premium was received or the half-price offer expired. As expensive as it has been to **obtain new subscribers**, then, experience has proven that equally aggressive levels of financial investment in high quality editorial content and good circulation service are required to **retain subscribers** as well. The true cost of acquiring circulation, then, is not the cost of the sales

programs alone but the entire investment required to provide subscribers with the levels of product and service quality that they demand.

Summary

No one familiar with paid daily newspapers, then, would dispute three essential facts about the business:

1) circulation and **market penetration** are the essential foundation on which all newspaper revenues are derived

2) **obtaining** and **retaining** subscribers to a newspaper is not an automatic process, but is instead a difficult and expensive requirement of doing business, and

3) declining circulation and penetration of paid daily newspapers has been a **long-standing trend**, and will very likely continue to be an industry-wide concern for years to come.

There is little evidence to suggest that the solutions to the problem will be inexpensive or immediate, and no reason to believe that **any** paid daily newspaper in **any** market is immune from ever-increasing competitive pressures and reader expectations. Despite this, a paid daily newspaper must continue to **obtain** and **retain** subscribers, since cessation of efforts to do so would inevitably result in the attrition of an essential revenue-producing asset and failure of its business.

Continuous investment in product enhancement, circulation sales and subscription retention strategies have **always** been a normal operating cost of **doing business** for paid daily newspapers. Even more so today, these investments are a required cost of **staying in business** in an increasingly difficult and competitive environment.

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DEFENDANT'S EXHIBIT 1

HERALD COMPANY
CONTROL NO. 5I1612

THE FAIR MARKET VALUE OF THE BOOTH NEWSPAPERS INC.'S SUBSCRIPTION LISTS AS OF MAY 31, 1977

PREPARED BY
JOSEPH P. BANIEWICZ
FINANCIAL ANALYST
INTERNAL REVENUE SERVICE
1111 CONSTITUTION AVENUE, N.W.
WASHINGTON, D.C. 20224
MAY 9, 1986

• • • •

IV. *Valuation Analysis*

A. Definition of the List

Before the value of newspaper's subscription list can be determined, it needs to be identified and defined. In the case of the Booth lists that were acquired by the Herald in 1976 and are the subject of the value allocation in the May 31, 1977 liquidation, they are the names and addresses of the specific subscribers to the various Booth daily papers. The names are evidence of the demand for the daily papers by individuals in the communities. They represent the communities' households, who want regular and continuous delivery of the dailies. It is the list of subscribers who can terminate the subscription at will if they no longer desire the product—the daily paper. In the case of the Booth papers in 1977, the company did not directly possess a list of subscribers on file in the newspapers' offices. Rather the lists were kept by the newspapers' carriers, who were not employees of the papers but rather were independent contractors of the papers. When a carrier terminated his or her relationship with a paper, the list of subscribers on the route was transferred to the new carrier. It is assumed for the purpose of this report that the lists were owned by Booth even though there was not direct possession in 1977.

In terms of the sale and circulation of the product, the daily paper, the lists possessed by the carriers is a valuable business asset that helps maintain a regular and stable circulation of a daily paper.

Circulation, in reality, is the very foundation upon which a newspaper publishing business is built. It is always a matter of first importance in the purchase and sale of a newspaper publication.

Circulation, as used in the newspaper industry, comprehends something much broader than what may be characterized as mere subscription lists. It comprehends, on

the one hand, a body of subscribers whom experience has demonstrated may be relied upon with some degree of certainty to continue to take and renew their subscription to the paper in the future. On the other hand, it includes within its scope an established advertising clientele who uses the paper as a medium by which to reach the purchasing public.

Circulation, the number of newspapers sold, is the lifeblood of a newspaper; it is the basis of all revenue. It is true that newspaper sales account for less revenue than advertising, but circulation is the force that makes advertising pay. Without circulation a newspaper would carry no advertising, and without advertising a newspaper could not survive. Circulation is the measure to which a paper meets the needs of the consumers in its community. The greater the circulation, the stronger the evidence that a newspaper is fulfilling the needs of its community.

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The subscription list of a newspaper is a valuable intangible asset. However, it should not be equated with the broader concept of circulation, which defines the franchise of a newspaper. The franchise is the value of an established newspaper's presence in a given market in the industry, that has naturally evolved in an economic sense to have monopolistic characteristics. The broader concept of circulation is inextricably related to the editorial and advertising product, the paper itself. This broader concept of circulation is related to and often termed goodwill. Goodwill is defined as that element of value which adheres in the fixed and favorable consideration of customers, arising from an established and well-known and well-conducted business. Goodwill in the newspaper industry for single daily markets such as the Booth papers is based on the circulation or preference of its customers to buy editions of its papers. The concept of goodwill in the newspaper business is called the franchise value due to the economic reality that without the circulation structure of an established paper, an out-

side publisher normally will not be able to come into a specific area and compete.

In contrast to the broader concept of circulation, the subscription list is the names, addresses and payment history of the subscribers, which enables the newspaper publisher to deliver the product on a regular and continuous basis to a large percentage of the purchasers of the editions of the newspaper. The broader concept of circulation and its significant value is related to and not separate and apart from the goodwill (franchise) of a daily newspaper.

B. Cost of Obtaining Subscribers

1. Company Interviews and Questionnaires

Newspapers are constantly attempting to acquire new subscribers. Newspapers in medium-sized cities such as Booth's undertake several promotions per year. In 1977, the Booth newspapers conducted circulation drives, which were mainly carrier contests. I obtained information from the circulation managers of each of the Booth newspapers on subscription drives. The circulation managers provided the cost range and indicated the varying costs depended upon the relative success of a given campaign. From the cost ranges provided, the midpoint unit cost for each of the newspapers and the average midpoint unit cost per subscriber were calculated as follows:

Cost of Subscribers as a Result of Circulation Drives

Newspaper	Unit Cost Range	Midpoint of Range
Ann Arbor Times	$8.00 to $18.00	$13.00
Bay City Times	$1.00 to $ 4.00	$ 2.50
Flint Journal	$5.00 to $20.00	$12.50
Grand Rapids Press	$3.00 to $10.00	$ 6.50
Jackson Citizen Patriot	$3.00 to $ 9.00	$ 6.00
Kalamazoo Gazette	$3.00 to $10.00	$ 6.50
Muskegon Chronicle	$3.00 to $ 5.00	$ 4.00
Saginaw News	$3.50 to $ 7.50	$ 5.50
	Average Midpoint Unit Cost	$ 7.06

2. Outside Sales Force Circulation Drives

Third party solicitation firms are occasionally employed to attract new subscribers to newspapers. Although when interviewed the circulation managers of the Muskegon Chronicle indicated that the paper did not employ this method, the American Valuation Consultants' report indicates that in September, 1976, the Jones Boys, a Michigan solicitation firm, was hired by the Muskegon Chronicle to obtain new subscribers. Over 3,600 new orders were sold at $4.50 each, with a 13 week money back guarantee. The $4.50 rate was for a combined daily and Sunday subscription. The rate for a daily subscription was $3.00 and for a Sunday subscription only was $1.50. The report also indicates that the Milne organization, another solicitation firm, quoted $5.60 to $7.00 (depending upon the area) per subscriber as the charge to successfully solicit subscribers.

Since the Muskegon Chronicle actually used the Jones Boys, who charged $4.50, it is my opinion that it represents the cost paid to an outside solicitation firm for the Chronicle and also the other Booth papers. However, the $4.50 per combined circulation unit is only the amount paid to the outside firm. The newspaper itself will incur internal cost in order to initiate the drive with the outside solicitor, promote the drive, process orders, and communicate the orders to the carriers. It is assumed that these internal costs will raise the total cost per unit to the $7.00 per unit level as determined in the previous section.

In conclusion, the cost of outside circulation drives and in-house circulation campaigns are approximately the same. This is a reasonable result because if there was a large differential in cost, the higher would not be used due lack of economic effectiveness.

The costs involved in either the outside solicitors or the in-house circulation drives of approximately $7.00 per subscriber, if applied without any adjustment to the total

number of subscribers of a daily newspaper, result in an overvaluation of the paper's subscription list. The overvaluation results because the circulation drives represents the cost of acquiring marginal subscribers. Most of the subscribers of a daily newspaper consider the product as a necessity and will subscribe with little or no solicitation effort. They desire the established daily paper in their geographic locale because of the news, information, and advertising that the paper carries. In contrast, the subscribers that are targeted in a circulation drive, are persons that are currently not subscribing for a variety of reasons, such as low income level (cost), illiteracy (usefulness) or newsstand sales (convenience). The marginal subscribers are more difficult to successfully solicit than the average subscriber that is acquired in a purchase of a newspaper property. Therefore, the marginal subscriber's cost, if used to value the acquired Booth subscription, would result in an overvaluation.

Although the marginal subscriber acquired in a circulation drive is normally more costly to obtain than those that are acquired in the purchase of a newspaper property, the value of the marginal subscriber in terms of circulation is less than those subscribers that are acquired in a total newspaper purchase because the marginal subscribers do not have the same retention rate as the average subscriber on the list purchased when a newspaper property is acquired. However, the value of circulation list of an acquired property is something that is attributable to more than merely the subscription list, the intangible asset that is separate and apart from the goodwill (franchise value) of the operation. The value of the subscribers on the list is derived from the fact that these subscriber want and need the daily paper. The daily paper is a product of the publisher, who has a monopolistic position in the specific market served.

It was indicated that using the cost of obtaining marginal subscribers results in overvaluing the subscription

list, acquired in a purchase of a newspaper property. The ideal, but nonexistent, situation from which to calculate the value of an newspaper's subscription list is one in which the established newspaper suddenly and completely loses its subscription list. The newspaper, with its same strong market position and same product, must then mount a subscription campaign to move from zero subscribers to the number it had before losing its list. Many customers would be easy to attract, easier than the marginal subscribers sought under normal circulation drives. Therefore, the average cost per subscriber would be less than the average cost per marginal subscriber of $7.00 previously indicated.

In 1977, telephone solicitation firms conducted their operations in a number of ways. One was to identify all the telephone exchanges in a given paper's area of circulation and to call all the numbers in each of those exchanges. This resulted in contacting all the telephone households in the circulation area, including unlisted numbers. The households telephoned were asked if they were currently subscribers. If they answered negatively, they were given the sales pitch. The firm's fee to the client reflected the cost of contacting both current and prospective subscribers. Since 1977, it was indicated at the interview of the Booth circulation managers that with the availability of electronic autodialers, Booth conducts similar operations inhouse to attract marginal subscribers. This process by Booth also provides a means to check carrier service to current subscribers.

It can be concluded that the value of the subscription list on a cost basis should be less than $7.00 per marginal subscriber. Based on this fact it is my opinion that a value of $5.00 per subscriber adequately reflects the cost that would be incurred in replacing the entire subscription list of an individual paper. The $5.00 figure is based on the efficiency of developing the entire list, where the success of soliciting would be higher than that of the

marginal subscriber campaign. Basing the value of subscription lists of Booth on costs of this magnitude is consistent with other taxpayers' appraisals that I have had the opportunity to review.

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It could be argued that the later revaluation is the result of additional new subscribers that replace some of the original subscribers acquired in 1977. These new subscribers, who may be (1) new households formed in the market, (2) households migrating to the market, or (3) existing households of the market deciding to subscribe to home delivery, would be capitalized at the cost equivalent to the circulation expenses that may be elected to be capitalized under I.R.C. Section 173. They would not be capitalized at values of the magnitude proposed by the Herald Company; they would be capitalized at values of the magnitude indicated by the cost of new subscribers or the market value of lists acquired separate and apart from a going business, although they may be expensed under the legislative grant of Section 173.

Conclusion

It is my opinion that the fair market value of the Booth newspapers' subscription lists should be based on the value of $5.00 per subscriber (for daily and Sunday combined) that was determined in sections of this report on the Cost of Obtaining Subscribers and Market Valuation of Lists. Since there is not an equal number of daily and Sunday subscriptions for each of the newspapers, the Sunday subscriptions are valued at one third of the $5.00 value, or $1.67 per unit, and the lists' value is adjusted upward or downward on the $1.67 value depending upon whether there are more or less Sunday subscriptions than daily subscriptions. The value of a Sunday subscription at $1.67 reflects the relative value of a Sunday subscription versus a combined daily and Sunday subscription on the basis of cost paid to a solicitation firm.

Based on the information on the number of daily and Sunday subscriptions supplied by the Herald Company and the values of $5.00 for a combined daily and Sunday and $1.67 for Sunday only, the following values are calculated for the individual newspapers' subscription lists:

Newspaper	Subscriptions Daily	Subscriptions Sunday	Fair Market Value
Ann Arbor News	37,743	37,122	$187,678
Bay City Times	37,337	36,255	185,203
Flint Journal	91,366	91,155	456,478
Grand Rapids Press	120,011	106,859	578,091
Jackson Citizen Patriot	35,711	35,632	178,423
Kalamazoo Gazette	51,481	52,960	259,875
Muskegon Chronicle	41,203	40,609	205,023
Saginaw News	49,327	48,942	245,992
Fair Market Value of Subscription List			$2,296,763

In summary the fair market value of the Booth newspapers, Inc.'s acquired subscription lists was $2,296,763 and such value does not reflect any adjustments due to I.R.C. Section 334(b)(2).

This value reflects the value of the subscription lists as an intangible asset, separate and apart from the going concern and goodwill (franchise) values of the newspapers. This value is distinguishable from the circulation value determined in the teaching of the *Donrey* case in that it does not encompass the value of circulation in its broader sense, which is not separate and apart from the going concern and goodwill (franchise) of newspapers.

Submitted by,

/s/ Joseph P. Baniewicz
JOSEPH P. BANIEWICZ
Financial Analyst

Attachments No. 1 through 6

DEFENDANT'S EXHIBIT 5

FAIR MARKET VALUE STUDY OF BOOTH NEWSPAPERS, INC. FOR THE HERALD COMPANY AS OF MAY 31, 1977

American
Valuation Consultants
a subsidiary of
Valuation
Research Corporation

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Newspaper Subscribers

The newspaper subscribers are intangible assets which generate direct subscription revenue. Newspaper subscribers are those who arrange to have newspapers delivered either by mail or other carrier to their home for a specified period. The subscribers are billed monthly by the newspaper.

Our valuation of the newspaper subscribers is based upon the amount a rational investor would be willing to pay for the subscribers who will continue to subscribe for a fixed period of time. With the passage of time the list of actual subscribers purchased at the valuation date will diminish as old subscribers stop taking the newspaper. New subscribers will not begin taking the newspaper without some effort and expenditures on the part of each newspaper for promotion. Therefore given an expected remaining life for any given subscriber, a rational investor purchasing these newspaper subscribers would be willing to pay only for the value associated with that subscriber over his expected remaining life as a subscriber.

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TESTIMONY OF DR. GERALD J. GLASSER

(February 5, 1990)

DIRECT EXAMINATION

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[51] Q Earlier you stated, Dr. Glasser, that the first step in a statistical research study is to help a client formulate the problem in statistical terms.

What was involved in the first step in the case of the Booth newspaper studies?

A I think I got it a little bit in answering a previous question, but there were several discussions with the clients. It was considerable thought on my part.

There were several internal discussions and the end result followed the talking and thinking was that we would do a statistical study, the end result from which would be a set of mortality tables that would describe the experience one should expect from the subscriptions as of that point in 1977.

That is, these tables which show the expected number of cancellations over the years, the expected number [52] of continuing subscriptions over the years, and enable calculation of such things as, average remaining life of the subscriptions.

Q Now, you also mentioned earlier that part of the work is—in the engagement of this type, is to design an effort to collect relevant data.

What kind of collection data was involved in the Booth newspapers studies?

A There was a large data collection effort. It involved surveys of subscribers.

That is to say, we actually went out and interviewed thousands of subscribers to the eight newspapers and obtained information from them which were then subject to, at a later stage, the statistical analysis.

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[70] Q You mentioned that in technical terms, these relationships are reduced to mathematical formula.

Can you give us in lay terms the essence of what the formulas are about?

A Well, the formulas related to—relate to age, to mortality of whatever elements and the population you are [71] speaking about.

And vice versa, if one has studied the mortality patterns and one would have to study something over time, then they could predict age distribution at any point in time.

In our case we did the reverse. We studied age distribution over time, plugged those numbers into the appropriate formulas and calculated the mortality tables.

Q Is it ccrrect then, Dr. Glasser, you calculated mortality tables directly from the tables on the ages of subscriptions that statistical research collected?

A That is essentially correct.

Q The procedures are described at least in outline form in our report and they are fairly standard applications of statistical method.

Q Does the use of the probability theory that you described imply, and I am asking you this based on your expertise as a professional statistician, does it apply or assume anything about the process by which newly added units are added to the population?

A No. Probability theory is not concerned with the causes of cancellations, and it is not concerned about the causes of additions.

Probability theory or its agent, which in this case is me, is simply concerned with the situation as it exists, [72] and assessng that situation and interpreting that situation, but relies on the data and not on any qualitative judgments or studies of why the population is changing.

Q Dr. Glasser, in your expert opinion can you and other professional statisticians estimate with reasonable accuracy the remaining lives of the paid subscribers of the Booth newspapers as of May 31, 1977 by applying

generally received statistical theories methodologies and techniques?

A Let me say first of all for myself, and the answer is yes, I can, because I did.

As far as other people, I would say that anyone with proper training and background would be able to do exactly what I did.

We have two points that he or she would have to contend to with, number one, the data have to be collected in a way that is acceptable to one of the profession, and number two, you use those data on a favorably straightforward manner, as I did, to calculate the required information.

Q Dr. Glasser, could you describe for the Court how, if at all, the remaining lives of the paid subscriptions of the Booth newspapers compared to the useful lives of the subscriptions?

A I am not sure I am completely qualified to answer.

If there is some technical meaning to the word [73] "useful" or legal meaning to the word "useful," it is beyond me.

If by "useful," you mean the period of time that a subscription continues in force and generates income for a newspaper, then I would say that remaining life is synonymous with useful life and by measuring remaining life, if I would measure useful life—

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CROSS EXAMINATION

[85] Q Exactly, Mr. Glasser. There are two different ways of looking at it.

If you did the study of the mortality tables for the Booth newspapers two weeks after this study, the effective date, say you took the subscription list two weeks later, would the mortality tables be any different?

[86] A If they were different, I would suspect that they would be trivially different.

Q What about a year later?

A Again, I would if somebody asked me if they were any different if I did the studies today, I would suspect they would not be.

Q Exactly.

In other words, if you look at the total number of people you could do your study every year, even up to the present date, 12 years, 13 years later and you would come out with the same statistics that you came out in 1977?

A I want to make sure that is clear that that is an assumption on my part, but I believe we would come out with a very similar set of results.

However, one would want to keep in mind that those results apply to an entirely different group.

The results that we came up with applied to subscribers as of a particular date 1977. If we did a study at this time, it would apply to a particular group of subscribers in 1990.

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[89] Q So those subscribers would have an expected life of 11.93 years still to go?

A Correct.

Q So the table actually says that these—some of the subscribers will still be left 50 years after the purchase?

A Some of the subscriptions.

Q So basically your table just sets out the remaining lives for the subscribers of each of the newspapers from basically zero to 40 years?

A Correct.

Q And, in fact, you state that there would be people still left as subscribers after 40 years?

A Correct.

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EXAMINATION BY THE COURT

[91] THE COURT: What is there in the survey that would [92] indicate to you the number or percentage of persons who would cancel their subscriptions and when they would do it?

THE WITNESS: That is implicit in a study of the ages of existing subscribers, ages, again, in terms of the age of the subscription. That is implicit in the data.

And a birth and death process or renewal process operates in such a way that as in any given period of time, there are some cancellations and some deaths, some dropouts, and additionally there are some additions.

Now, looking at historical circulation data for the newspapers, I was able to observe that essentially the overall number was constant and when I see that, I know how to interpret those age data and construct a mortality table on those age data, but it is implicit in the age data.

The alternative to doing that kind of study is not a feasible alternative at all. That would have been to take the subscribers at a given point in time, and study them for 20 years, and see how we did, and all statistical techniques are attempts to make predictions from the past, and when you—that is all we ever have is the past. We never have information about the future.

So this is, in that sense, a standard statistical application of using information as it exists to make predictions about the future.

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TESTIMONY OF ROGER J. GRABOWSKI

(February 5, 1990)

DIRECT EXAMINATION

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[113] Q Based upon your expertise, what conclusion do you and Price Waterhouse reach as to the fair market value as to May 31, 1977 of the paid subscribers of the Booth newspapers?

A We concluded, based on our investigation analysis, that the total fair market value of the paid newspaper subscribers as of May 31st, 1977 was $60,470,000.

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[114] Q As a preliminary matter, can you explain what are the alternative—might be called basic approaches to valuation?

A Valuation is not an exact science.

Valuation is an exercise of measurement of many factors to arrive at a conclusion.

Value in and of itself is a forward-looking conclusion. It is not a conclusion as to what something was in the past.

People pay money, willing buyers to purchase, willing sellers to sell, based on expectations of the future.

[115] Whenever you are dealing with expectations of the future, you are dealing with one known, so the valuation consultant tries to draw on tools that have been developed, different approaches to try to narrow the gap in his understanding of the various ways that people can look at an asset, can try to measure what they are willing to pay, willing buyer, willing seller.

And valuation theory has really developed around three approaches: An income approach, cost approach, and a market approach.

And it's the goal of the valuation consultant to utilize these tools, these generalized approaches applied to specific circumstances and, by the way, one or more may not

be applicable or it may not be able to apply a specific approach to any specific asset. But utilizes these approaches to try to understand the process people go through in coming up with what purchase price or selling price, because you are trying to simulate the willing buyer, willing seller auction.

This is particularly difficult where you are doing an allocation of purchase price.

You are dealing with a basket of assets for which a purchaser paid one lump sum.

The assets of a business are very interrelated. The assets of a business do not produce oftentimes income, [116] separately.

The fixed assets are interrleated with the inventory, are interrelated were the intangible assets, are interrelated with the personnel, are interrelated with the goodwill.

So it is the valuation consultant's task to use those approaches to dissect the business and associate the value that contribute, each asset makes to that business.

The premise in allocating the purchase price are the values of the assets as part of the ongoing business, not separate, standing alone, liquidating value.

This is a very basic sort of premise that underlies everything.

You see this in inventory valuations. You see it in going back to Jack Daniels and Nap King Size Shoe (phonetic), where the court cases upon which a whole theory of accepted ways of valuing inventories, treat inventories on the basis of their contribution or value as part of the business, not sole naked as liquidated. You see, this is fixed assets.

My classic example I always use is, an old client of Price Waterhouse, no longer a client, but was a client of American Valuations of Price Waterhouse, which was Oscar Meyer.

I don't know if you ever have seen a weiner tunnel, [117] but that is one of the special purpose machines that

they put something in this one end, that some people call meat, and at the other end out comes a weiner.

THE COURT: That is a former client.

(Laughter.)

A And out comes the other end, weiners.

Well, that weiner tunnel, separate from the business, has a scrap value because no one would buy it. It is a specialized value.

Yet, if you are in the meat processing business, making weiners, a weiner tunnel has a very high value. It contributes to the business.

So the valuation consultant has to start with the basic premise that he has a basket of assets. He has a business that generates profits, and try to determine how all of—each of those assets contributes, and therefore those within that confine are the value of the assets as part of the ongoing business.

Q Now, you mentioned earlier there are three basic approaches.

Did you take a moment—would you take a moment and explain what each of the approaches, is please?

A Well, start with the cost approach.

The cost approach is a basic valuation approach that begins with the premise of replacement cost, as being [118] the starting point.

That is, the cost approach says a willing buyer will consider in part of his deliberations, and a willing seller in part of his or her deliberations, what in fact the replacement cost would be of an asset.

Now, we all know that sometimes replacement cost or costs approach—cost approach takes into account the fact sometimes an asset isn't as good as a brand new one, so you reduce the value of full replacement cost for observed depreciation.

Now, the easy one to think of, you can observe the depreciation on my automobile with its rust. So the replacement cost less some observation for depreciation gets you down to a cost approach indicator of value.

A cost approach is based on the premise of substitute, why would I pay anymore for an asset, being a willing buyer, then it would cost me to buy an asset based on its replacement cost.

I use the word indicator because I learned that replacement cost doesn't necessarily mean value, and this can go both ways.

For example, just north on this side of the Hudson River, just north of the New York/New Jersey border there is an office complex. I don't know what it goes under now, but it one time was called the Blue Ridge Office Park.

[119] It was a large development, and I know because I was involved in the valuation as it has regards to some bankruptcy.

There was a complex of office buildings that had a replacement cost new, and in fact had just been constructed, which were in excess of $30 million, between 30 and $50 million. Willing buyers presented with the opportunity of buying that office complex, acquired it for less than $20 million.

The replacement cost wasn't indicative of the earning capacity of that asset.

You read about it today in—for example, Houston, you can by office buildings within the last five years that were constructed for two or $3 million and the Resolution Trust Company would be very pleased to take a number far less than that. In fact, I know of sales of less than $50 million.

So that is one, where you see income, somehow puts a cap, income generating potential puts a cap on replacement costs, an indicator of value.

Let's go to the opposite side. I know of an example because it happened to be a relative of mine, where a small chemical company, small chemical company had a chemist out of school, the chemist out of school stumbled on an invention.

[120] That relative sold that business for many millions of dollars.

What was the replacement cost of the patented invention?

It was negligible relative to the value, so replacement cost is just an indicator.

Secondly—second approach, and I will go right into it now, is the income approach, and these are not necessarily preference between income and market, the next two.

But as I indicated from the top and bottom, that is, up and down from replacement costs, what generates or drives value is expected income, expected profits, expected flow.

These are concepts that drive value.

The income approach is the most true—the most truly indicative measurement of value, because that is really what people are willing to pay for is the—in an investment asset, is the income generating capacity.

The last approach is the market approach.

Going back to the income approach, the income approach when I talk about it, it's taking the capitalization or the present value of expected future income, you see this with buying an apartment building, buying a trade name, buying a business, is the [121] capitalization or present value of future.

The last approach that we use is the market approach. The market approach is one where you try to find observations of market transactions.

Now, sometimes you can, sometimes you can't. May be very difficult to find observations of market transactions for any one specific asset.

But what is always important to remember is that, the market approach is really a reflection of how people feel or their measurement of the income-generating capacity of an asset.

Use an apartment building, as an example. An apartment building you can observe market prices for apartment buildings.

But really what is driving market prices is capitalization of income. That is what makes market prices go up and down.

The market is the consensus of willing buyers and willing sellers about income, expectations.

So if you can observe the market approach, it's really an—or market observations, I use the apartment building as the example with kinds of observations that people have.

I have reason to discuss in the last day or so rules of thumb of businesses, accepting to be rule of thumb [122] we are discussing about beer distributors.

Several years ago, ten years ago, the rule of thumb was between two-fifty and $3 a case, was the fair value of a beer distributor business, that is, you took the annual cases of beer sold by that distributor times this rule of thumb price, and that was the rule of thumb market value.

Today, that rule of thumb is in excess of $5 a case, but those are just broad guidelines.

That doesn't mean that that is the correct price for every beer distributor.

The market price is simply these rules of thumb that people use to value businesses are sort of an average of what people see being paid for those kinds of businesses, based on analyses that willing buyers have done and willing sellers must have done to accept the price.

• • • •

[123] Q Mr. Grabowski, before the luncheon recess you explained each of the basic approaches to valuation.

Can you explain how an expert appraiser determines which approach to utilize in particular evaluation exercise?

A Well, when approaching any evaluation, an evaluation consultant really looks at it from the standpoint of constructing an evaluation of model of some sort.

Remember, we are dealing particularly in an instance like this one, with valuing a group of assets.

That is, there was a lump sum purchase of assets, and our goal is to associate the various values of the assets as they contribute to the overall income generating capacity of the business.

So in looking at each and every asset, an evaluation consultant looks based on his experience and study of the specific assets which have the valuation techniques, first of all, he might be able to apply because of data availability.

For example, for the paid newspaper subscribers of the Booth newspapers, there is no market for paid newspaper subscribers apart from buying the business.

[124] You can't go read The Wall Street Journal, and there is a quotation for paid newspaper subscribers.

And by the way, you can't read The Wall Street Journal and find a listing for a quote for a weiner tunnel either, so going back to my previous example, so you say that there are no direct observations you can make for certain assets out in the market, special assets that have contributory value to the business, which don't sell necessarily separate from the business.

So you discard the market approach in these instances, and then you examine the other two approaches, cost and income.

Now, the question arises from the cost approach, which again is just an indicator of value, can you design a valuation model that captures what really is the replacement cost of the assets you are looking at.

For example, if you were valuing computer software, some computer software is very straightforward. It's the number of lines of code, how many lines of code does it take on the average for your systems people and programming people to come up with per day, given historical analyses, but sometimes what is embodied in a computer system has really little relevance to the historic mantime that may have been placed on it.

This can be both from the—again it can be up or [125] down. It may have great value relative to the

number of hours of Lotus one, two, three, a popular software package that is sold.

Clearly that software package has value far in excess of the manhours that were taken to code the software, and on the opposite side I have seen software where the number of manhours that have been expended trying to develop a software far exceeds the value.

Why? Because they made mistakes.

In trying to construct evaluation model from the cost approach, descending on the assets it can be very difficult.

In the instance we are here, were paid newspaper subscribers, we are dealing with newspaper subscribers which have certain expected characteristics. They are seasoned.

That is, they are not all the new guys on the block, the first time taker of the newspaper, and therefore trying to just use the cost of a solicitation as a single number, I solicited—I got solicited to take the newspaper for 13 weeks, because I got a teddy bear kind of promotion around Christmastime for—in the Chicago area for newspapers, some sort of stuffed animal with a 13-week subscription.

You have to get many, many of those first time subscribers to take the newspaper before you can create a [126] comparable group of newspaper subscribers, a comparable—comparable newspaper subscribers with the same expected characteristics for useful life for how long they are going to take the newspaper.

I will give you another example. I see this done with a number of mailing lists, and I see that this is a common way of building a mailing list by renting other people's lists, and then sending out catalogs until you get a response.

Because when you are building a mailing list, you rent other people's lists. I am sure we have all gotten something, where you look at the label and say, oh, I can tell that I—that list I was on that subscription list or that

credit card list, American Express sold my name and now I am getting mailings from somebody.

It takes many, many mailings. Some response rates are half a percent to five percent, just complete success. That is considered unbelievable success.

But a half a percent of a million names for someone to just say, yes, I want to be on your mailing list, so if I were to begin one, and I went out and solicited new participants in my mailing list by mailing one of my catalogs to all of the list of names off the American Express, I may come up with a half percent, one percent response.

[127] And then I still don't know if myself as a respondee will have the same sort of buying characteristics or future repetition response, but I do know that it takes many solicitations to get a respondent who has characteristics of someone who is already proven to be a seasoned respondent or seasoned subscriber.

Q Now, in preparing plaintiff's number three, which have the three basic valuations approaches, did you utilize—

A After looking and discarding the market and after discarding really the cost approach as an easy way of coming up with what value construct, model built around it, we use the income approach.

Q When you prepared your earlier report dated May 4, 1979, while at American Valuation Consultants, Incorporated, did you utilize any other approach in addition to the income approach to value the paid subscribers of the Booth newspapers as of May 31, 1977?

A Yes.

Back in May, of that report of May 31st, 1977, I did attempt to build a valuation model around a cost approach.

But again very artificial, because you can't say here is the cost to acquire a seasoned subscriber. I can tell you what the cost is to solicit a new one, give us a teddy bear in 13 weeks and you can get somebody to sign up.

[128] But he—that subscriber does not have the same life characteristics of a seasoned repeat subscriber.

Q Now, why did you conclude that you would not use that cost approach in the valuation report presented with your testimony today?

A Well, first of all, it was 13 years ago and I am a lot smarter today, and I put it together at a time to attempt to measure, to try to represent additional evidence as to the value of the newspaper subscribers.

It was an artificial model construct at that time, because I am trying to capture something that is not easily captured, and I felt it was really too difficult to explain.

So even though it supported the value that was derived from the income approach, I felt that it was artificial in its construct, its construct and certainly inferior to the use of the income approach, I felt that then that is why we did not use it again.

* * * *

[132] Q Let me ask you, Mr. Grabowski, are the valuation principles that you have just described that you used in this valuation exercise, ones that you applied uniquely to this case, or are they generated-accepted principles within the community evaluation experts?

A They are certainly not unique for this as far as my application of them.

And they are not unique as far as my knowledge of other people's work is concerned. It's a very commonly accepted approach.

I know this because through my role at Price Waterhouse, we have many tax and audit clients that have had over the years, and continue to have their valuations performed by other valuation consultants besides our other people at Price Waterhouse.

As part of my role I am called on very often to review the work of other people, the methodology, the theory that we have applied here is very consistent with the

generally accepted valuation theories being used to value paid subscribers.

* * * *

[137] THE COURT: Let me ask you this first.

Why in column seven do you only have reference to the collection cost? Why do you not include the production costs of the newspaper?

THE WITNESS: If your Honor—your Honor, if you think about the model that I described, evaluation model, and you look at the alternaitve method of operating a newspaper, one is paid circulation newspaper for which there will be revenues minus collection costs.

And the other is a free distribution newspaper, where there is editorial contents, paper, there is all of the other costs, the only difference between these two is the marginal revenue minus the marginal costs that the subscribers bring to the paid subscription payment.

* * * *

[139] THE COURT: I understand that. I am saying, what about the cost of the paper itself to the company engaged in delivery?

In addition to the cost of delivering it, they have to purchase the newspaper, either the newspaper has to be published by the company distrubiting or bought by the company engaged in distributing it. You don't get it free.

THE WITNESS: I agree.

If I have a company and I could run my publication having subscribers or distributing it free, the added value from having the subscribers to me as a publisher is the revenue net of expenses of collecting the cost, and by the way, revenue is net of the delivery costs, that is the actual revenue being received by the newspaper.

That is the difference in incremental revenue as publisher of the newspaper is how much I receive from these subscribers net of the incremental costs that I have.

[140] Even if I am getting it free, free distribution, a reader, for example, there is paper, editorial costs, they have to solicit advertising, all of those costs are still there.

The difference in its valuation model of how you incrementally say, what does this asset add to the value of the business, is the incremental revenue that these subscribers contributed to the Booth newspapers over their remaining life.

THE COURT: In the hypothetical I gave you, distribution was separate from the production and publishing of the newspaper, in valuing that company, distribution company, you would certainly deduct the cost of acquiring the newspapers as well as the cost of delivering it.

THE WITNESS: Yes, but I would do it for both cases whether it was a free circulation paper—I would have to get my revenues somewhere.

Presumably, if I was a distribution company, I was collecting money and paying something for the paper.

If I were strictly a free newspaper, if that was the service I was providing to the publisher, I would distribute it free, but I would be getting paid directly by the publisher from his advertising revenues.

So in either case, I would—I, as the distribution company, would be receiving it.

* * * *

[143] Q In that context, Mr. Grabowski, how would you—looking at it hypothetically as opposed to a particular newspaper, how would you confine, in your estimation, the expense categories of the two comparable papers, one being a free circulation paper and the other being a paid circulation paper?

A Well, in the valuation model we built, we had with the expenses, other than those associated with collecting the revenue, that was the difference in the expense because both types of newspapers would have—would have editorial content.

Q What kind of expenses are involved in having editorial contents?

A Paper, writers, photographers, people that go out and solicit news stories to put in the paper, cover news stories in both instances.

[144] I am not talking about newspapers here that have world-wide news bureaus one become another.

I am saying there are two ways of operating, and the difference between these two operations is the—is the marginal revenue that is associated with the newspaper subscribers—

Q Looking again at the two—the mode we will use, the term comparable one being a free distribution paper and one being a paid circulation paper, which of those would have the expenses of say pressman, for example?

A Both newspapers.

Q Which of the two examples would have the—which of the two papers would have the expenses that—say an advertising sales force?

A Both of them. Advertisers don't come in without efforts.

Q Which of the two papers would have for example the expenses related to delivering the newspaper, say, from the point of production to the point of distribution?

A Both of them.

Q What revenue—what would be the differences in the revenue streams of the two institutions?

A The free paper would not have subscription revenue.

The paid circulation paper would have subscription revenue.

[145] Q Assuming for the moment you were looking at two papers in the same community with the same distribution and the same kind of advertising contents and the same kind of editorial content, what expenses would one paper have that the other would not?

A Oh, cost of collection, certainly, because in order to get the revenues in, I have to go and have some effort to collect the costs, and if that is part of the expenses of the newspaper, and that happened to be how this was operated in the Booth chain, is Booth itself and the people that went out and collected, I had to deduct it. The collection people didn't keep a slice off the top of the revenues.

Okay.

Q Could you explain to the Court why in your expert opinion, this particular methodology that you used results in the determination of the fair market value of the paid subscribers of the Booth newspapers as of May 31, 1977?

A Well, we used the income approach. And in my experience, the income approach is the way that willing buyers make decisions on purchasing assets that they are holding for investments or to generate income.

However, I know this, during the time that I have been at Price Waterhouse, much of the work I do is assisting buyers and sellers of companies determining—buyers and sellers of assets, determining how much to pay or how much [146] to see as an offer, for a specific company or asset.

And my observations, that these decisions are based on income measurements, and therefore we have applied a method that parallels the world of decision-making, and that is what is the income generating capacity of a specific asset.

* * * *

[147] By the way, your Honor, one other way, as I am sitting here thinking and trying to formulate an answer, if you had two newspapers, forget that they are a shopper, for example, let's go to a daily that the principal distribution is the coin box, it doesn't have to be free versus pay.

It's the difference between the value of the circulation that is paid in the coin box versus the revenue that is distributed or received from a subscription.

We are not valuing the coin box revenue. I could have a newspaper that that is how it's distributed.

USA Today is basically a coin box distributed newspaper.

Paid subscribers have characteristics of longevity, of measureable life that say this subscriber has [148] expectations, I am going to receive extra revenue from

them, a lot stronger than the revenue that I may get from his putting a coin in the box.

* * * *

Q Can you explain for the Court whether based upon your expertise, you reached any conclusion as to whether the paid subscribers of the Booth newspapers was set separate and apart from the goodwill of the newspapers?

A In my opinion, they are separate from the goodwill of the newspaper.

Q How did you come to that determination?

A Well, first of all, they have a useful life that is determinable with reasonable accuracy.

Second of all, they have a revenue, an income that is measurable, that is identifiable with those assets.

In my experience, in my opinion, the two characteristics, the combined characteristic of estimable useful life, reasonable determinable with reasonable accuracy, and directly associated and measurable income from those assets, lead me to believe that I have identified and separated an asset from goodwill.

[149] That to me, in my experience, in my opinion is a test.

Q Based upon your expertise, Mr. Grabowski, how would you define the reputation of the newspaper such as the Booth?

A Reputation and integrity, those are elements of goodwill.

I am not saying that goodwill can't influence assets or values in a business, and in fact, goodwill—in valuing the assets in an allocation, your Honor, this is their interplay in the business of all of these assets, and goodwill can influence the value of other assets as well as other assets can influence the value of goodwill.

* * * *

[152] THE COURT: Let me ask you this: if the average company that has retail sales of a customer, you certainly would not in the typical case take the average

prior years, whatever it is, net or gross sales and say that is an independent asset separate and apart from goodwill, would you?

THE WITNESS: No.

THE COURT: Ail right. What is there about subscriber lists because they are indeed, they are the customers of the product, are they not?

THE WITNESS: One category of customers of a product.

THE COURT: Is it a fact that they are predicted to continue on one of the items that distinguishes this from the mass of consumers that buy a particular product?

THE WITNESS: They are individual people who have a predictable characteristic of return. That characteristic is something in the real world people are willing to pay [153] for.

That is an asset of value in the real world, predictability, returnability.

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[155] Q In your expert opinion, what is the appropriate method of determining the value of the goodwill of an enterprise such as the Booth newspapers?

A My opinion, the appropriate opinion for valuing goodwill [156] is the residual approach, that is, taking the purchase price or fair market value of the entire business, subtracting the value, all of the identifiable and acceptable assets and the amount that remains is the goodwill. Sometimes concerned value gets thrown in there, but that is goodwill.

Q Why is that the correct methodology from a pricing or—standpoint?

A Goodwill, there is no concise formulation of how you measure specifically goodwill.

If it's integrity and reputation, those are nebulous, and once I get all of the assets that I separated from goodwill, what is left over has to be unassigned or unassociated with anything and represent the excess earning power that

people were willing to pay for and traditionally, excess earning power has been used as a measure of goodwill.

Not being defined as goodwill, but as a measurement.

Q Based upon your experience, Mr. Grabowski, what is the Internal Revenue Service's view of that methodology of viewing the goodwill of an enterprise?

A Generally that is the method the IRS prefers, even prior to the current change in the current tax law.

Current tax law mandates the residual method at the behoval of the IRS of that being the method. Prior to that time my experience was that most of the time that was the [157] position that the Service took was the—that the residual value was the correct method.

• • • •

[159] Q Based on your expertise, could a free circulation newspaper have goodwill?

A Certainly. Can have reputation, integrity, people—can have all of the kind of elements.

It can ruin its goodwill just like paid circulation can.

Q Again, based on your expertise, how would you respond to the Government's contention that the paid subscribers of the Booth newspapers are not the appropriate assets to be valued, but if any assets should be valued, it should be the subscription lists of the newspapers?

A Well, certainly that is not what people are willing to pay for lists of names and addresses.

What people are willing to pay for are the expectations of measurable and estimably—estimated with reasonable accuracy useful lives and revenue streams being generated. This is the principle that in the Citizens in Southern case was used.

I valued core deposits for a number of financial institutions. That is the principle that here is a preditable amount of the deposits called core deposit base. [160] It wasn't the value of the list of the people that were depositors.

It was the income that was being generated. That is what we are valuing here.

Q Based upon your expertise, how do you respond to the Government's contention that kind of the real assets of value in this case is what they call the customer structure or subscription structure of the Booth newspapers, and that that assets lasts essentially forever, or is what is sometimes called self-regenerated?

A Well, first of all, anybody who knows anything about publication and the solicitation that goes on to attract new subscribers, and this is true in varying degrees with all types of subscribers, very rarely do you find something that quotes itself regenerating. People have to make efforts.

I tried to think of an example and one struck me when I got off the airplane driving past Anheuser-Busch brewery.

Don't think all I do is think about breweries.

(Laughter.)

A That is a brewery structure. Five years ago it looked the same. Five years from now, it will look the same.

But inside it's made up of individual machines, individual tanks. The machines five years ago that were there, some have been replaced, others will be replaced in [161] the future. Over a time spectrum, you can think of a brewery as being a brewery structure.

And yet the equipment from today and ten years from now is not going to be the same equipment.

These ten years from now, if everything that was estimated in terms and the stability that was experienced, et cetera, I would want paid—again going to my first thing, that the Ann Arbor News data would have daily subscribers, but they are not going to be the same subscribers as the 37,744 that were acquired on May 31st, '77.

Just as much as the fixed assets in that brewery are not going to be the same ten or fifteen years from now.

• • • •

[162] Q If one were to carry your analysis and this may be a little repetitious to some of the questions the Court asked, but let me ask anyway to be clear.

If one were to carry your analysis to its logical conclusion, would that mean that the customer's structure of all businesses would be depreciable?

A No. Their are many businesses.

Your Honor used the example of a retail.

I happen to have—my wife and I have patent in a chain of bed and bath linen shops in the Chicago area.

We have customers that come in every day to buy sheets and towels, but we don't know if they are coming back.

I would hope so, based on the reputation. I have no way of measuring that. They are not acceptable to me [163] from the goodwill of the business, because there is no way I can identify them, other than seeing their face when they come in, but I don't know when they come back.

There is no way of predictability. So certainly, in that example, that customer and they have customers, there is a customer structure. So this is, in my opinion, a fact and circumstance issue. This is not an issue of that, is the same in all circumstances.

We used the newspaper before where we had with the circumstance of puttting the coin in the box. That was the principal method of circulation. People do, people don't.

I can't identify who those people are. Therefore I can't separate them in the traditional generally accepted methods of determining a value and life of an asset to find an asset that is separable from the goodwill.

I have no easily determinable useful life and I can't recognize a revenue associated with that asset with that —with those customers to our retail stores.

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CROSS EXAMINATION

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[169] Q What asset did the corporation—the Booth newspapers hold evidencing a relationship with these paid subscribers?

A The past commitment of these subrscibers to take the newspaper, their current agreement to take the newspaper, and Booth had a likelihood that these people would continue taking the newspaper within a reasonable degree of accuracy.

Q So they had a relationship with these subscribers, that is the most you can say, isn't it?

A The subscribers had made a commitment to take the [170] newspaper.

Q So the Booth newspapers had a commitment, is that what you are describing as this asset? You are depreciating a commitment?

A No. Depreciating paid newspaper subscribers.

You asked me how it was evidenced. It's evidenced that they were committed to take the Booth newspapers.

• • • •

[178] What I am showing, and I will continue to show that the Booth newspapers could have solicited every household in all eight areas under Mr. Grabowski's formula, $4.50 per household for a total of $3,300,000, every household in all eight areas, a total of 724,400 households.

I am saying that he rejected the cost approach.

Q I want to know why when you you could have solicited every member of the original subscription list for $3,300,000, why you rejected the cost approach.

THE COURT: I will overrule the objection.

MR. TURKUS: I will withdraw my objection to that question.

A Because the valuation issue at hand was what is the value of the newspaper, the paid subscribers, and I will use your Ann Arbor as an example, which and quoting from the report because there is an example in the report, has a remaining useful life for daily subscriber in Ann Arbor of [179] ten years.

So the question was: What was the value of a subscriber whose on the average remaining useful life is ten years.

The cost approach of soliciting for the first time is very similar to the example I used of building a mailing list, where I have to solicit again and again and again to get people to accept a commitment—making a commitment or expectation that they will take the newspaper for ten years.

I have no way of—this was an artificial construct, artificial model that I developed to try to bolster the value conclusion that the income approach had resulted—

THE COURT: Well, Mr. Grabowski, let me do to Mr. Hrebiniak that I have been doing all morning to Mr. Turkus.

If we go back to your comparison of the newspaper fairly identical with paid circulation and the giveaway, the Shopper, if all it takes to convert the Shopper into the paid subscription is the expenditure of $3 million to acquire that paid subscription list with the expectation that if you got the same subscribers, they would continue as they would continue under your present model, why isn't that the proper approach to take?

THE WITNESS: Because, your Honor, the issue in my mind is, and I understand this is not an easy issue, and it [180] has taken me some time to formulate it.

The issue in my mind is I could start a newspaper somewhere, forget where they are for a minute. Say there is a city with no newspaper.

I can start a newspaper, paid or free.

I know that if I have a paid—free circulation newspaper and people became accustomed to reading it, I will solicit them to started taking subscriptions.

Some people will say I liked it a little, but not enough to pay money, so you will pay an inducement.

Some people will take the inducement, take it for 13 weeks and say, "I didn't like it that much."

You will have to induce and induce and induce again some portion of that population until you can simulate or you can reestablish the same commitment to pay money, it isn't just reading it. It is the commitment to pay money for the newspaper with the same predictability as what was acquired in the Booth newspaper situation.

THE COURT: Why would there be such a tremendous discrepancy between the value you placed on it and the cost, I will not say replacement, because it is not replacement, but really of creating it?

THE WITNESS: In this report, if I can quote, the concluded value that I had for the cost approach was $40 million by the way, your Honor.

[181] The way I built a model, which I was never satisfied with at the time, but which helped—if you remember, your Honor, the questions that the appraisers tried to use a couple approaches, if they can, the conclusion of value is that I used as the cost approach was in excess of $40 million.

That is what was—what I estimated at the time would require this repetitious buildup of a group of subscribers, of individual subscribers that had the same characteristics.

Now, let me go back again for a second to the mailing list example, because I find that this sometime is useful for me to understand.

I have to solicit millions of names to get a million names. I might have a point five percent, first by—people will—you get mailers from people with a new mail order catalog. You may get the mail order catalog five times before you ever respond, if you ever respond.

It takes a lot of efforts of resolicition to build the predictable commitment that these newspaper subscribers have, and that is what I tried to construct in the cost approach as I had them.

And as I said, when Mr. Turkus asked me the question why did I change, I said I am smarter today.

It isn't that I couldn't come up with what [182] construct or model that gave me a number, but it was an artificial way of trying to regenerate something. This asset, newspaper subscribers with characteristics that I couldn't go out and buy.

I can't go out and buy newspaper subscribers with predictable characteristics to read the Ann Arbor newspaper daily for the next ten years.

* * * *

[184] Q Now, the other thing is that you have taken all of the marginal income, as you call it, and we will get into it later, from these subscribers, and you have allocated absolutely none of that to goodwill, is that correct?

A I don't know what you mean.

Q You have taken all of the marginal income from these subscribers, every cent of it, every fraction of a cent of it, and attributed it all to the newspaper subscribers who you say is separate and apart from goodwill. Is that correct?

A We have taken the present value, not all.

Q Present value?

A Minus direct cost.

Q You have taken none of it, not even a fraction of one [185] cent have you distributed to goodwill.

MR. TURKUS: Is there a question, your Honor.

Q Have you?

(Laughter.)

MR. HREBINIAK: Thank you.

A We distributed revenue minus marginal to this asset.

Q None to goodwill?

A Goodwill based on the residual approach back—you can look at the report, was 77 million.

Q None of the money to goodwill?

A No.

* * * *

(February 6, 1990*)

* * * *

[336] Now, summarizing the income approach you took the revenue generated per subscriber.

Now, that is the actual amount that they paid for a newspaper, correct, per day?

A. No. That was the actual amount that was received by the newspaper.

Q I should have finished.

The gross revenue then was the amount that they paid, 30 cents a day or back then, probably 15 cents a day, is that correct?

A That would be of the gross amount that they paid, whatever the correct amount was. I do not recall.

Q And then you would subtract from that amount, the cost of delivery, and then eventually you would subtract from [337] that amount the cost of collection, is that correct?

A We took the net revenue that was received by the newspaper, minus the cost of collection.

* * * *

[345] THE COURT: Suppose you have an office in the newspaper, a subscription department, I do not know four, five, people, they are taking up a 20-by-20 space, how does that figure into the calculation?

THE WITNESS: Your Honor, I would have to go back and review exactly how we calculated it.

We took into account the expenses for those personnel, and I think it included—I, quite frankly, don't remember the totality of the expenses.

But any directly-related expenditures to the activity of billing and collecting the money, so if there was, for example, and I deviate that from the controller of the newspaper, you know, the accounting department of the newspaper, where those—just general bookkeeping, we do

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* The remainder of Mr. Grabowski's testimony is reprinted out of chronological order for the convenience of the reader.

[346] not include any expenses related to that. Because in both instances, the controller's department would have been there, whether it was a free distribution or a paid distribution newspaper.

THE COURT: So, in other words, under those circumstances, you would distribute nothing in the way of overhead expense to delivery and collection from the paid subscribers?

THE WITNESS: Your Honor, I would have to reread what exactly we—what was said both in the report and when we did those calculations back in 1977 in the consultant evaluation reports.

BY MR. HREBINIAK:

Q I certainly would appreciate receiving that information myself.

Isn't it a fact that basically what you did was calculate that the subscription price is approximately 15 cents per day, and from that you subtracted what the newspaper actually just delivers at the dock to the distributors who were independent contractors, which is two-thirds of the price of the newspaper, isn't that all you did to calculate the delivery costs?

A We took into account whatever the net revenue was that was received by the newspaper.

* * * *

[350] Q All right. Okay.

So when the—when a newspaper then is delivered to a customer who pays for that newspaper, there was nothing actually deducted out of this revenue stream for the cost of that newspaper. Is that correct?

A Which costs of the newspaper?

Q Of producing the newspaper. Physical product itself.

A You mean the—is this the paper, is that one of the costs you are speaking of?

Q Well, what are the costs—yes. That is obviously one of them, the costs of producing the newspaper?

A Okay.

No. Because in the difference between a free distribution newspaper and a paid distribution newspaper, paid subscription newspapers, the newspaper costs, printing editorial, et cetera, would be there in both instances.

Q But you know, we are really not dealing with the free newspaper here.

As a matter of fact, are there any free daily newspapers in the country that you know of?

A I don't know of any.

• • • •

[354] Secondly, advertisers actually pay more for advertising, where there is a commitment on the part of paid subscribers to take the newspaper.

[355] I don't know how much more they did. In fact, I tried to study that, and it's inconclusive from the evidence that I have been able to piece together at the time.

How much more advertisers are willing to pay, because you, as a reader, have put down money, so if anything, by not including advertising revenues, this incremental amount of advertising revenues, that I could not specifically quantify. If anything, I felt that maybe I even underestimated the revenues generated by having paid subscribers.

But I did know that I could have if there were no newspapers, I could have a free—in a specific area, I could have a paid or nonpaid circulation daily.

It turns out that I don't do it because I like the revenue of a—have the paid circulation, I like that revenue, it's a benefit to me.

If I can establish myself as a paid circulation newspaper, I am increasing my revenues.

Yesterday, your Honor, we talked about, you know, the idea of bringing in more of these revenues.

These revenues to contribute to the profit of a newspaper.

It's not that I don't like them. It is if the guys that have already been in a marketplace sort of put their stakes down and gotten people to commit, and I am a new [356] player on the block coming in, I am going to break into the market with a free newspaper, later try to convert it to a paid newspaper, because that is extra revenues.

But in the sense of I am still delivering the product, I am delivering the advertisers' message, and they are the principal source of revenue of paid newspapers.

• • • •

(February 7, 1990)

RE-DIRECT EXAMINATION

• • • •

[399] Q Mr. Grabowski, you were asked questions I think on Monday, and in fact you just heard colloquy of counsel concerning it.

In your 1979 report you utilized the cost approach in addition to the income approach to value the paid subscribers of the Booth newspapers as of May 31, 1977.

Can you explain briefly the methodology you applied in usig the cost approach at that time and the rationale that was underlying that methodology?

A Well, as I spoke now going back, I think till Monday, about the desire, if possible, for an appraiser to use—or [400]valuation consultant to use multiple nothings, I recognized the difficulty of trying to establish an estimated replacement cost for newspaper subscribers that have certain life characteristics, certain expectations in the future.

For example, I think in the statistical research report, I recall that Ann Arbor's—the useful life of the Ann Arbor's subscribers from the report was ten years.

I recognize that I can go out and obtain subscriptions from a solicitation house.

They would go out and canvass the people and get me subscriptions.

But if I were starting a newspaper in a marketplace, and I think I recall I used $4.50 as the solicitation cost would just get me a 13-week subscriber, they wouldn't get me a ten-year subscriber.

So if I started, I would just get a 13-week subscriber.

So I attempted to estimate what it would cost me, knowing that if I acquired the Ann Arbor News, I obtain subscribers that I could predict a ten-year useful life, what it would cost me as the willing buyer to ensure that I could get ten years worth of subscribers.

So I analyzed what it would cost over a period of time, going back, knowing the churn, as I understand it, that is, people who take the subscription for 13 weeks and [401] say, "Well, send me another teddy bear."

And I analyzed it by dividing the 10 years into a 13-week period and how much I would have to spend every 13-week period, knowing the churn to ensure that I had 10 years worth of subscribers.

I analyzed that to the present value of that cost, and that was the replacement cost, as I think I quoted sometime before from having read the report when it was handed to me, the total estimated replacement cost value, indicator of value is in excess of $40 million.

Q Now, you also indicated in prior testimony, I think on direct and also on cross-examination, that you did not utilize cost approach when you prepared the report which has been accepted as Plaintiff's Exhibit 3.

Why did you conclude that you would not use the cost approach when you prepared that report?

A Well, first of all, I felt it was very artificial. I don't know what it would cost me in a true sense to go out and replicate or reestablish a ten-year relationship with subscribers. I don't know that.

So I made up a model which I felt was—which could have some problems with it.

Since I did that report, I also learned that courts in the United States have recognized that the income approach is the appropriate method of—the income approach

[402] as the accepted method of valuing intangible assets like the paid newspaper subscribers, and I accepted that that is the—theoretically I knew that that was the correct approach, and I accepted that that is the best way of presenting the evidence as to the value.

* * * *

[404] Q In that hypothetical scenario we are talking about, if you assume for a moment that the buyer could reestablish the relationship with all of the prior subscribers over some period of time, in your expert opinion would the cost expended in that effort, if we assume it was $4.50 a household the way Hrebiniak posited it, would those costs represent the full and complete cost of reproducing the subscribers that you had as of May 31, 1977?

A No.

As I stated, the—I attempted in the cost approach model to simulate that idea, and that was to start over again.

Now, I am an investor. I can go to a market with no newspaper, start a newspaper, or I can buy a newspaper with subscribers and pay for that asset.

I went and said, what would it cost to—what would it cost me to—to—to—to initiate that.

I quite frankly don't know. It happens over long periods of time, and I know a lot of money is expended to [405] get paid subscribers with a certain life character over time, and the reason the money—because—I will use the word churn again.

Q Would the solicitation effort, the cost of that solicitation effort in that hypothetical, in your expert opinion, represent the fair market value of a paid subscriber of the Booth newspapers, whatever the cost was, would the cost of reestablishing those relationships represent the fair market value of the paid subscribers, if you could determine what the cost was?

A No. As I testified before, the cost was simply an indicator of value.

The income approach is the appropriate method of valuation.

I used—I think I could use the example of a—happened to be an uncle who had a company and had a chemist that invented a patented product.

You have—all of a sudden there was a company worth millions of dollars.

The incidental salary of three months' worth of a chemist is—hardly equates to the cost. Similarly, the coding of Lotus 1, 2, 3, development cost, which is a very popular software package—the software package alone is worth millions and millions of dollars—just doesn't reflect what somebody might come up with as the replacement [406] cost, so cost and value are not synonymous.

* * * *

[408] Q Have you had an opportunity or on the evening recess to review your records about what costs were subtracted or offset?

A Yes, I have.

Q Can you explain to the Court—having refreshed your recollection, what it was that you did subtract?

A We subtracted, your Honor, the salaries and fringe benefits and the direct expenses of the district managers and the cashiers and the extra help with regards to collection.

[409] The district managers perform many functions besides going out to the newsboys and collecting the revenue.

The expense that the newsboys have of collecting the revenue has been reduced from the amount of the subscription revenue that the newspapers have.

The district managers perform many functions, and I substracted all of the costs of the district managers.

Q Now—

A And these other support people, the principal people involved with the district managers.

THE COURT: But all experiences directly related to collection?

THE WITNESS: Correct.

THE COURT: But again no production costs, nothing to do with the production of the newspaper itself?

THE WITNESS: No, your Honor, because whether they collected one dollar of revenue or no dollars, there would be the production costs of producing a newspaper.

Q Now, there was some dialogue, I think it might have been yesterday between you and Mr. Hrebiniak, might have been the first day, about delivery—allocating or deducting delivery costs, and sometimes he used that terminology and sometimes your answers talked about what we attributed to the subscribers was the net revenue received, but there was [410] a dialogue sometimes delivery costs was used and sometimes net revenue.

Can you clarify for me what is confusing in the record for me on that?

A Well, if the delivery is made by someone who picks up the newspaper at the dock, we did not subtract any delivery costs, because in the price the newspaper receives, there is a deduction already for the delivery costs, so the delivery cost is implicitly deducted.

Similiarly, if it's delivered by Booth to a distribution point, we did not subtract delivery costs because a free newspaper would have to get the newspapers out there anyway.

So in both instances, we have left the delivery cost to something that is then—been absorbed by the newspaper, other operations, not by the subscribers.

Q So to the extent you may have said you deducted delivery costs, you meant in the context of somebody who came to the paper and picked it up and did the delivery themselves, by attributing all the income the paper got from them, there was a netting out of delivery charges. Is that correct?

A Yes.

Q But you did not actually allocate against or offset, subtract from the subscription revenue stream that the paper actually received any delivery costs?

[411] A No. Because those expenses would be there regardless of whether the newspaper was free or paid.

Q Now, you testified that you did not allocate a portion—you did not allocate any production costs—in fact, you just answered a question from the Judge about that a moment ago—to the subscribers as a subtraction from the subscription revenues.

In the model you used, in your analysis where did those costs get allocated?

A To the advertising revenue.

Q Why is that the case here?

A Well, the first item that an appraiser has or evaluation consultant has to do in applying the income approach is understand the principal source of revenue, why are these expenses being expended, what generates the revenue.

The principal source of the revenue in newspapers are the advertisers.

They pay to obtain their advertising, to put—have their advertising placed in front of the readers.

You then look and see if there are any by-products. The subscription revenue minus the additional revenue the newspaper receives from subscriptions, minus the additional expenses is really a by-product of the activity of delivering the advertiser's message to the reader.

We took the additional revenue minus the additional [412] expenses. That present value is the basis for the fair market value.

This is a common accepted method where there are by-products to a principal function.

Q Can you give the Court any examples of other valuation exercises, where valuation experts would agree that the correct way to determine the value of an asset is to determine the present value of the additional revenue

brought to an enterprise by that asset without allocating any costs other than additional costs, as a subtraction or offset in that revenue stream?

A As I left the hotel this morning, one struck me which was looking across the street at the Pennsylvania Railroad Station, New Jersey Transit and Amtrak are in the business of running trains.

I also noticed that they have leases, at least with Mc Donald's, for example. The value of that lease of having Mc Donald's in there is the revenue received from Mc Donald's minus whatever additional expenses there might be.

The Pennsylvania Station, Downtown Newark, would be there regardless.

We don't subtract an allocation of the maintenance costs of the track from the revenue that Mc Donald's generates for New Jersey Transit and Amtrak.

That is a by-product of having the station. That [413] is the value of that lease.

Another one that came to mind was—if I were a manufacturer of newsprint, and I have a large boiler generating steam for my newsprint manufacturing operation, I may enter into a contract to sell the excess steam to a power plant. This is a very common popular way of generating—generating additional revenue.

The additional revenue is this by-product generates minus the additional expenses would be the value of that contract with the utilities for the cogeneration, what is called cogeneration.

So where you have a principal and a by-product that by-product is value, that contractual or that expectation of relationship is valued based on the additional income minus additional expenses.

• • • •

[414] Q And how does that translate to the valuation exercise here, this notion of by-product?

A Well, the primary reason newspapers are in business from an economic standpoint is to charge money to advertisers to present their message in front of readers.

The advertisers support the newspapers.

[415] Q And how does the subscription revenue fit into the economic analysis?

A Well, that is the by-product, and you can get the commitment of subscribers, or readers to pay money to be a subscriber, whether that a quarter a week, a dollar a week, $5 a week. That is a by-product of the principal function, that contractual or that relationship that is predictable is an asset of that business, and the appropriate method to apply is to measure the additional revenue minus the additional expenses that that asset brings to that business enterprise.

• • • •

[421] THE COURT: Suppose the parties have entered into [422] this agreement for the total purchase price, and on the eve of the sale or even after it's consummated, the Booth papers come to the Newhouse group and say our computer is down, we have lost our subscription list, we can no longer identify who our subscribers are, and they come to you as an impartial expert and say, we are entitled—the purchaser is entitled to a credit as a result of the seller's inability to identify the subscribers.

Is it your opinion that they would be entitled to a $60 million deduction of the purchase price? Isn't that really what you are saying?

THE WITNESS: I don't know what it would cost to correct the deficiency. In actual fact there is multiple records because you have newsboys of lists of—

THE COURT: No. Assuming that it is lost. You spoiled my hypothetical.

THE WITNESS: Sorry.

THE COURT: Not the cost of reconstructing it, possibly the cost of replacing it, which we have been discussing for a few days now.

Is it your opinion that the appropriate way to value the credit would be, as you have done it here, based upon the income approach and that the purchaser would be entitled to a credit of $60 million as against the purchase price because of the inability of the seller to deliver and [423] identify the subscribers?

THE WITNESS: It would be my opinion that the fair value is $60 million, and that the purchaser would be entitled to a credit based on the lesser of the fair market value or the cost to correct, if that were possible in some fashion.

I know that there is a court case, for example, going on in the Minneapolis about the dome where the Twins and the other sports teams play, and the dispute is whether the cost to correct—what is the damages.

The fair value has been represented as a dramatic value in the fair value because the dome has a problem. There are alternative ways of correcting it, and the damages in this situation are being measured as the least cost method of correcting it.

That doesn't mean that the value of the dome hasn't dropped.

THE COURT: No. But I take it, based upon your opinion in the case and redirect by Mr. Turkus today, that it is your expert opinion that the cost approach would not be an appropriate measure of value here and that the proper measure is income, and thus $60 million.

THE WITNESS: Yes. The proper method of income—is—is—is what is the value of that asset to the Booth newspapers? What is the additional revenue minus additional [424] expenses that that asset generates for both newspapers was $60 million.

THE COURT: All right.

MR. TURKUS: If the Court please, I would like to ask a few questions about the hypothetical.

I would like you to follow through with me, Mr. Grabowski, one at the time.

THE COURT: You may, because these are created on the spot for me, so if you want to add to it, be my guest.

MR. TURKUS: I think I have a different hypothetical.

BY MR. TURKUS:

Q I would like you to follow through with me one at a time, Mr. Grabowski, and take your time if you need to reflect on each question.

In the Court's hypothetical, the night before the transfer was to take place, the seller said, "I have lost the list of names and addresses."

A Uh-huh.

Q Let me ask you first: If in that hypothetical is what the credit would be, is what the asset that is gone, the paid or paying subscribers, or is that the subscription list, names and addresses of the subscribers?

A Just the list is gone.

[425] Q And let me move to a different hypothetical a moment.

Suppose there were the contract that the Court posited to you, and the night before the transfer the seller called the buyer and said, "We have to tell you there has been horrible news, there has been a catastrophic event, all 40,000 subscribers to the X paper died last night."

A Okay.

Q Now, what asset would they not be able to deliver in that circumstance?

A They would not be able to deliver the subscriber relationship of 40,000 existing paid subscribers paying, using—or—or—or paying subscribers using your Honor's terminology.

Q Suppose we had closer to the case, all eight papers, and you had all 460,000 odd paying subscribers who died the night before the transfer, what kind of a credit would you say the buyer would be entitled to in that circumstance?

A Well, certainly total fair market value of the subscribers.

Q Which, in your opinion, was what number?

A Was $60,407,000. I have to look at the exhibit, the table, to make sure I have the right number.

MR. TURKUS: If the Court please, I am presenting Exhibit 3 to the witness.

A As I concluded on page 11, it would be $60,407,000.

[426] Q Now, with that hypothetical question and your reflection on that, putting that—putting the other question in that context, as compared to that, if the buyer called up and said,—seller called up the buyer and said, "Last night we lost every existing copy of the lists of names and addresses of the subscribers," would you say that they would be entitled to the $60 million odd credit or something less, whatever the value is of the subscription lists?

A They would be entitled to whatever—the law as I understand in damages, they would be entitled to whatever it takes to correct that deficiency in the assets being delivered.

Q What asset would not be delivered in that circumstance?

A Just the subscription list.

Q And recalling your testimony from Monday, do you believe there is such an asset as subscription lists of paid subscription newspapers, paid circulation newspapers?

A Not the quesiton that I valued. I valued paid subscribers.

Q Is there such a list?

A Yes, there is a list. We can produce a list of names and addresses if you want.

Q. Is that the asset you valued in the case?

A No. That is not the asset I valued in this case.

• • • •

[427] Q Now, yesterday you were asked at approximately Page 355 of the transcript whether there were any free daily newspapers in the country, and as I recall, you said you didn't know of any.

During the evening recess, has any additional information come to your attention in that regards?

A Yes.

I had occasion to read an article in Press Time, one of the trade journals of the newspaper business which talks about free daily newspapers.

And there are several in the United States and I think it was 11 daily newspapers, including Aspen, which is a free daily in Colorado, and Ventura, Cailifornia, which is [428] between Los Angeles and Santa Barbara, I don't remember the others.

But they were talking about it as a way of operating a newspaper as an alternative, and there actually are some.

MR. TURKUS: At this time I would ask to have marked an exhibit which was not previously identified, because this issue has really come up in the course of this examination.

A copy was provided first thing today to Mr. Hrebiniak. I ask to have it marked as I think it's plaintiff's exhibit—I think, 9, but I will give—I think 9. We have the stickers.

We can do the marking, but I ask that it—

THE COURT: P-9 for identification.

(Plaintiff's Exhibit marked P-9 for identification.)

THE COURT: All right.

MR. TURKUS: There is an additional copy for the Court, if the Court please.

I ask to approach the witness.

THE COURT: Certainly.

THE WITNESS: Thank you, Mr. Turkus.

BY MR. TURKUS:

[429] Q I show you what is marked Plaintiff's 9 for identification purposes and I ask you, sir, if you can tell the Court what that document is.

A This is a copy of the Tuesday, February 6, 1990 Aspen Daily News.

Q And is that the free daily newspaper that you were describing earlier that was produced in Aspen?

A Yes.

From the article, I think it was published free for 11 years, and says it free in the masthead on top, volume 12, 1893 up in the right-hand corner.

MR. TURKUS: Plaintiff's move into evidence Exhibit 9 for identification.

THE COURT: Any objection.

MR. HREBINIAK: No.

• • • •

[435] Q Based on that analysis of the financial data for each of the eight newspapers, and reflecting upon your testimony [436] earlier today, are you suggesting then that the subscription revenue is really a by-product for each of the eight newspapers?

A You would make a profit based on the crude analysis I was able to do even if they just lost this revenue, and I have not reduced the expenses of the newspapers for going and getting subscribers after they lost the existing ones, going getting new ones and I know it's a big expense.

Q So it is a by-product or not?

A By-product of the principal functions of the newspapers, that is, to generate advertising revenue, to place advertisers' message in front of readers.

MR. TURKUS: No further questions.

THE COURT: I have another question.

THE WITNESS: Yes, your Honor.

THE COURT: Either on an individual basis or combining all of the Booth newspapers, did the advertising revenues prior to 1977 exceed the subscription revenues?

THE WITNESS: Yes. On the average of about 80 percent of the total revenues—total circulation revenues—total revenues and that circulation revenue is the 20 percent of subscription revenues less than what is left over.

THE COURT: So the ratio is approximately 80 percent advertising and 20 percent circulation?

[437] THE WITNESS: Correct, and paid subscribers are only a portion of the circulation.

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TESTIMONY OF DR. CHRISTINE D. URBAN

(February 6, 1990)

DIRECT EXAMINATION

* * * *

[206] Q Can you explain for the Court, if you would, the nature of the relationship, if any, for a paid circulation newspaper between the number of paid subscribers and the advertising revenues which such a newspaper can generate?

A The—let me define a term if I may.

[207] The paid circulation of a newspaper is represented by two groups. One, the subscribers that get the paper home delivered or through the mail, and another group of single copy buyers that buy the paper one at a time, either from a vending machine or coin box.

The number of paid circulation that is an important number, but not really the critical number in being able to impact advertising revenues.

The critical number is not how many papers are sold in circulation, but what percentage of the households in the market are covered by those papers.

So if you have a newspaper—there are newspapers that may be growing in circulation, but have an adverse impact on their advertising revenues because their penetration of the market, that is, the percentage of households that they cover is declining.

So the relationship between the two is based on that critical factor of market penetration.

Q Now, during the period 19—let me ask you this: Is there a relationship between the fact that a newspaper has a paid circulation and perhaps its penetration and the kind of advertising rates that the newspaper can charge its advertisers?

A Yes, there is.

Q How does that interrelate?

[208] A The paid daily newspaper in having subscribers and single copy buyers that would pay for the ad-

vertisers, give the newspaper confidence in assuring that their ads that appear in the newspaper are being read.

Therefore, the advertisers are more willing to pay a higher cost per thousand.

It's basically rate-related calculation of how much it's costing them to be able to reach thousands of these newspapers readers.

So the relationship between circulation advertising revenues is very clear in terms of the newspaper's ability not only to be able to convince advertisers that they are getting the audience that these advertisers are looking to reach, but also in being able to justify higher advertising rates.

* * * *

[211] Q Now, Dr. Urban, in your testimony you talked about free circulation newspapers and paid subscription or circulation newspapers.

Can you describe for the Court the differences, if any, between those two kinds of newspapers?

A If you look—if you were to go down the list of different characteristics of a newspaper and take a paid and a free newspaper, they would look remarkably similar.

There are significant investments made in both paid and free newspapers in providing news coverage and editorial coverage that enhances readership of the newspaper.

There are significant investments made in both paid and free newspapers in making sure that the publication is delivered on a timely and consistent basis and meets readers' expectations and customer service.

There are strategies in both paid and free [212] newspapers that deal with how to prove the quality of the audience to advertisers and be able to go out and look for advertising revenues from local stores or other merchants that would like to advertise.

So the only real difference that we can see from free versus daily, free and paid newspapers, is the fact that

paid newspapers have circulation revenue by charging their readers a subscription price or cover price.

Q Why in your experience, Dr. Urban, would a publisher of a free circulation newspaper make the kind of efforts that you are talking about in terms of editorial contents, delivery service, and in terms of things that are focused towards the readers when the readers are not paying for the product?

A Without the publishers and the owner of free paper have the same competitive forces on their audience as do paid newspapers.

You have the same kind of environmental factors, taking away readers' time and attention from reading the free paper as from reading the paid paper.

So in order to be able to create the audience and generate advertising revenues, as well as to insure that they have an audience permission to issue, it is important to invest in providing people with news and information that has some relevance to them, and is of quality enough that [213] they would be willing to spend their time reading that publication, so the goal is the same.

The goal of the paid and free newspaper is the same, to be able to provide the readers with news and information in an attractive and professional, and high quality way to get them to read the newspaper and in doing that, provide an environment for the advertisers to insure that their message would be—

THE COURT: Do advertisers view the two types of papers differently?

Would they have more confidence, assuming that both the free and the paid go to every house in a particular area, would the advertisers have more confidence in the paid subscription newspaper as opposed to the free?

THE WITNESS: The paid newspaper often does not —the paid portion does not go to every house.

THE COURT: Assuming that.

THE WITNESS: Assumption that, a lot of it depends on the quality and relationships that have been built up with those readers.

What free newspapers have to do, because they don't have the circulation revenue or the paying portion to be able to prove that that—that the readers are desiring the paper and using the paper, they do market research studies or readership studies in order to survey the people in the [214] market and find out not only how many of them are reading it, but how frequently they are reading it.

So they have to be able to prove it in some way and they often do it through market research.

The advertisers are increasingly more confident in the ability of the free newspapers to be able to attract an audience and hold onto that audience, as evidenced by the fact that many major advertisers, including large department stores and large automobile dealerships, and a variety of other very good advertising accounts are buying full page or two full pages or three full pages in free newspapers.

MR. TURKUS: Thank you, your Honor.

Q Based upon our experience, Dr. Urban, how do you respond to the government's suggestion that free circulation newspapers simply do not have the significant editorial contents found in paid circulation newspapers?

A I dispute it.

I think the only free publications that I can think of that don't have news editorial contents are Shoppers, and we are not talking about Shoppers.

We are talking about free newspapers that have significant editorial content, even to the extent in the sad experience of some of our clients before we started working with them, that readers in the market would sometimes tell us on surveys that they prefer the news coverage that they [215] are getting from the free weekly newspaper to what they are getting from the paid daily newspaper.

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[225] Q Dr. Urban, based upon your expertise, how would you respond to the government's contention that,

and I am not asking you this now based upon any evaluation connotation, but only on the contents of what they have said, they contend that, page 12 of their brief, that the Morning Ledger's valuation experts make a plainly erroneous representation that, and I quote, in this case they are quoting from valuation testimony in deposition, I believe:

A paid subscriber payment and a free distribution newspapers have the same categories of revenues and expenses with the exception of the subscriber revenue and the cost to collect that revenue.

Based upon your expertise in the newspaper industry, how does that comment hit you?

A Could you—they are saying that that is an erroneous assumption?

[226] Q Correct. Say it's plainly erroneous.

A To me, it's plainly erroneous to look at newspapers like this and assume that they do not have the cost structure in terms of the news editorial costs and cost of delivery service and cost of producing as high quality a publication as this is, and so I would contest that.

I think that it's very clear based on my experience, not only in paid daily newspapers, and my knowledge and our companies' knowledge of the cost structure of paid daily newspapers that we consult with, but also my personal knowledge of free newspapers' cost structure that they have essentially the same components of cost with the exception of the cost of collecting circulation revenue.

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[236] Q Based upon your expertise Dr. Urban, can you tell the [237] Court whether these matters you described are of material concern of the newspapers in the conduct of their business?

A They are of critical concern and material concern because the inability of the paid daily newspaper to retain paid subscribers is putting at risk, not only their circulation revenues, but the credibility they have with the advertisers, and being able to deliver the audience and the kinds of coverage that they require—that the advertisers require for their advertising message.

The examples of advertisers that have gotten newspapers to not only continue, but even improve news editorial contents simply is a way of being able to maintain this audience and environment for their ads are quite numerous over the last few years.

So it's an issue not only being addressed and worried about and worked on by the newspaper industry, but very much of interest to the advertisers and the customers as well.

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[238] Q Directing your attention to pages 23 to 25 of plaintiff's Exhibit 4, your report, Plaintiff's Exhibit 4, would you tell the Court where in that report you summarized some of the efforts that newspapers take to replace lost subscribers and to maintain market penetration?

A Yes. I do.

And summary is a good word, because if one were to list out as oppose to summarize, if one lists all things newspapers did to try to retain subscribers or be able to solicit new ones, I think it would go on for an awful longer than two typewritten pages.

What are summarized here are basically four areas that newspapers have been working in very steadily, on Page 23, the two summary statements of that, newspapers—most paid daily newspapers I am familiar with in the United [239] States, Canada and elsewhere, have been making and have continued to make increasingly aggressive and increasingly expensive investments in circulation sales.

Now, circulation sales programs come in a wide variety of shapes, sizes and colors. They include not only telephone solicitation and being able to get on the phone and talk to nonsubscribers and other people and to try to sell them a subscription to the newspaper, but also door-to-door sales and what are called boy crews, which is a

variation on the door-to-door sales of sending either the carrier or carrier's supervisor to the door to solicit.

Many newspaper started to distribute free samples of the newspaper two or three days.

In some cases, some newspapers have sampled nonsubscribing households with two or three weeks of the newspaper to get people familiar with the product to order it and subscribe to the newspaper.

There are external promotions, advertising campaigns, televison ads, premium offered, sweepstakes to participate in. Wingo Bingo, variety of different promotional techniques designed to be able to sell subscriptions to newspapers.

Now, in addition to investments made in circulation sales, that is to gain more subscribers, there are an awful lot of programs that are being used by newspapers across the [240] United States to retain current subscribers. A lot of the programs concentrate in one of two areas.

One area being circulation service, which is taken from market research surveys or from complaints, people write in or call in about the service, the critical expectations that people have and trying to fix those.

For instance, one of the—one of the things that often happens with a newspaper and its home delivery service, is that, for instance, if you are on Johnny Jones' route and Johnny Jones, who is your carrier, and has been your carrier for a year or two, always put your newspaper inside the screen door to keep it from getting wet and keep the dogs from chewing on it and a variety of other things, Johnny Jones passes his route over to Billy, and Billy, who doesn't even know that you used to get your newspaper from Johhny put nicely between the screendoor and your front door, does what all carriers would consider to be good service, which is, to put your paper on your front stoop, right in front of the door.

It is sad to say, but a lot of people will call the newspaper and complain that they are no longer getting their

newspaper between the screen door and the door because that became their expectation of good service.

Even though industry standards would argue if the newspaper is in front of your door, as opposed to in the [241] bushes or three doors down, you have good service.

So all of these customer service programs and subscriber attention programs are very dependent on knowing what the subscriber's expectations are, not just an abstract principle of what a newspaper would consider to be good service.

The retention programs on home delivery, and when the paper gets there, and how the paper is delivered, and whether or not the paper is in a plastic bag or not, all of those factors in their absence could be the cause of a dropped subscription.

So newspapers are very much aware of or want to be aware of what people want and meet those expectations.

The other side of retention programs has to do with news editorial contents and making sure that the surveys include measures of not only what people are reading in the newspapers, which is a traditional kind of product measure, but we have been asked for years to ask on surveys, what do people want to read in the newspapers, so that more contents could be added and more information and news could be put into the newspaper to give it a better chance of being retained by its present readers.

So those two factors are clearly investments that are being made and have been made for years in the industry.

Other investments that are being made in trying to [242] overcome the problem of declining penetration are, I am happy to say, increasing numbers of newspapers hiring market research to be done, not only on their readers, but also on nonreaders, to ask what would it take to be able to get you to subscribe to the newspaper, and to trap the success of all of the retention and sales programs that I just described in something other than just an ad hoc way.

In other words, the investments in the newspaper industry in sales programs and retention programs have gotten to such a monetary amount, that it's worth it now to pay to track the results of the program.

In other words, the dollars at risk in these strategies to be able to grow circulation and grow subscriptions have reached a significant enough level that it's worth the incremental cost to track to see how successful it could be, and if it is not as successful as you like, to have consultants such as Urban & Associates come in and make it more successful because we are really working at that kind of level of improvement necessary.

Q The efforts that you mentioned that related to improving delivery service and changing the contents or qualities of the product, newspaper that they actually delivered to their subscribers, are those expenditures related only to retaining existing subscribers or are those expenditures very much part of the effort to obtain new subscribers or [243] replace lost subscribers?

A It's very difficult to divide them and say, this hundred thousand dollars went for objective A, and this hundred thousand dollars went for objective B.

The kinds of programs, both sales and retention programs are dependents on so many factors. They are dependent on the news editorial quality, the service quality, the home delivery service quality, the responsiveness of a newspaper to something as simple as answering the phone when people call.

I don't know of a way to be able to take those dollars and say, this should belong to that objective and this should belong to the other.

Q How widespread are the efforts you described to the Court throughout the industry?

A They are widespread.

Every newspaper that I can think of in the United States has some degree of program in both retaining as well as in trying to attract new subscribers, from the very smallest to the very largest.

Q Tell us, based on your personal knowledge, whether these kinds of efforts were engaged in by the Booth newspapers?

A From what I read of the Booth Newsaper's history and my knowledge of the market, yes. They were engaged in Booth markets.

[244] Q Are the matters you described thus far in your testimony here today and the views that you stressed, simply opinions that you form in connection with your testimony here, or are these views widely accepted throughout the newspaper community at large?

A I would say that all of the views I expressed are widely accepted. It would be difficult to find somebody knowledgeable in the industry that would argue with any of the points.

Q Could you describe for the Court, the relationship between total paid circulation, paid subscribers and single copy sales for a paid circulation newspaper?

A The total circulation—total paid circulation of a daily newspaper is made up of two groups.

The home delivery—home delivered subscribers or those that get subscriptions through the mail, commonly referred to as subscribers, as well as the second group of single copy buyers and single copy buyers could be buying it from a stand, newsstand, rack, coin box, a boy standing at the intersection before the toll gate selling a newspaper by him.

In most cases, a daily newspaper would have significantly more subscribers than single copy buyers with the common ratio being '80 to '85 percent of its total paid circulation represented by subscribers and then, of course, [245] the 15 or 20 percent represented by single copy buyers.

The importance of both of these two groups is different and yet complimentary.

The subscribers have—as a matter of measurement by the Audit Bureau of Circulation, the subscribers have value, as do the single copy buyers, but the difference is

single copy buyers are, in most cases, not buying the paper seven days out of seven, but buying it on whatever day they feel they would like to read the newspaper.

So, therefore, a single copy buyer can't be counted on to the same extent as a subscriber to be in the audience either for that day's column, if I am a columnist or if I am an advertiser, to have the same kind of probability of seeing that ad.

So the two components don't make up paid circulation, but the subscribers and single copy buyers have complimentary functions when you look at how people come in or leave the market of a newspaper.

Very often, whether you move into town or whether you decide to switch newspapers, whatever the case may be, an individual will often buy single copies of the newspaper long before they sign up for a subscription to give it a try, to do a trial of whether or not its meeting their information needs and advertising information needs.

Single copy buyers then often are entry level [246] subscribers, and its extremely important to keep single copy availability high and make sure that the quality of those copies and the care taken with being able to sell them is just as high with subscribers because many people are deciding whether or not they should subscribe to the newspaper.

Likewise single copy sales are important because of the concept I referred to before as churn, and these are individuals who subscribe to the paper but because of dissatisfaction often with service, they said, look, I don't want to be a subscriber any more, I quit subscribing, but they quit the delivery but still buy it once or two times a week, and they become single copy buyers again, as a critical component of the audience, but not as tied or as loyal to the newspaper as would be—as they would have been when they were subscribers.

And the critical thing to think about, although it's a concept unfortunately not measured by the Audit Bureau of Circulation is frequency of readership.

One of the things that subscribers—that adds to a subscriber's value is the fact that they have a higher availability and higher chance of reading the newspaper every day.

And a single copy buyer, you have to sell them the newspaper every day, and they can just as easily decide not [247] to put their 35 cents in the box as they can put their 35 cents in the box, so there is just one more obstacle being put up to a newspaper attracting them into the audience than there would be with the subscriber.

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[249] Q Based upon that experience, Dr. Urban, do you have any opinion as to whether the subscribers in the Booth newspapers as of May 31, 1977 were likely to subscribe indefinitely to the papers or whether the subscribers were likely to have a limited duration?

A Those subscribers would have a limited duration and I would say would not subscribe indefinitely.

Q Now, what factors would lead you to conclude that the paid subscribers to the Booth newspapers as of that particular date were likely to have only a limited life during which they could be expected to continue as subscribers to those newspapers?

A A variety of factors.

First of all, the trends that we looked at in terms of historical attrition and churn were the Booth [250] subscribers.

The second is the fact that within the Booth markets, I saw no dearth of the environmental problems or demographic or lifestyle changes or competitive changes that I described earlier, as being the causes of this kind of decline.

So you can see the evidence of it in declining market penetration, and you can look for the factors that would cause it, and that is clear analysis, that Booth markets were neither immune from any of the factors, nor did any of their historical penetration changes belie the fact

that they are also—their newspapers also have subscribers that will drop off.

Part of this is indeed just common sense, people do die. People do get sick. People do move away.

Some of the Booth markets had economic downturns in terms of the automotive industry or high unemployment that in some cases the market shrunk because people moved away. They moved out to find jobs somewhere else.

But in addiction to those kinds of overall factors, there is also clear evidence that these newspapers were suffering from the same kind of external problems others do.

Q Based upon your expertise, Doctor, can you tell the Court approximately how many new subscriptions a newspaper must satisfy in a given year to maintain its subscriber [251] levels?

A That number of course varies by market and the size of the newspapers.

But my experience is, most of my clients and most newspapers would be doing solicitation and circulation sales programs to be able to write half their list.

In other words, if they have 100 subscribers, they would be writing 50 orders every year in order to just maintain that level of circulation.

In other words, let me explain it the other way.

In other words, to end up with one paid subscriber at the end of the year, a typical number would be that you have to write 10 or 15 or sometimes 20 orders to be able to bring those people into the subscriber pool, and then 19 of those 20 will drop off, leaving you one actual increase.

So that although the number varies, the proportion seems to be about the same approximately in newspapers across the United States.

THE COURT: I am not sure I understand that.

You mean there is a 50 percent attrition rate in paid subscribers?

THE WITNESS: Let me describe it in terms of process, because I think it's easier to understand.

Let's say you have a newspaper that has 100 subscribers right now, and you know that just because of [252] natural factors people die, move away or the fact that they have become dissatisfied, that of those 100 subscribers, it's not unreasonable that 10 or 15 or 20 of them will not be there by the end of the year.

In order to stay at that same circulation level, not even increase it, but to stay at that level, you have to crank up the phone solicitation and direct mail solicitation and all of the rest of it, probably to go out and write at least 40 or 60 or, sometimes, 80 orders in order to end up with people that will keep that circulation at the same level.

Running faster and harder each time you do it, because there is a certain degree of wear-out factor by the time that you had the sixth phone call from the solicitor.

THE COURT: If you made no efforts to replace customers lost, what do the statistics show as to the probable attrition rate in a year?

THE WITNESS: If you make no efforts to replace those people, then not only would those people be gone, but you probably would be losing at a faster rate as time went on, because a lot of this is just keeping the news editorial and service levels high and keeping sales levels high as well, so they would drop off, I would hesitate to say, like flies, but quite quickly in terms of paid subscriber declines.

[253] BY MR. TURKUS:

Q Let me ask you this:

In response to a question from the Court, you said, you posited a paper with a subscriber base of 100 subscribers, and you said maybe 10 or 15 would fall off in the year, and in order to stay even, they would have to sell 40 or maybe 60 or even more subscriptions.

Assume we are talking 40. What happens to the 25?

I mean if you sell 40, why do you only pick up 10 or 15 that you lost, what happens to the rest of them?

A A lot of things.

Let's say that—let's accept for sake of this hypothetical that you wrote 40 orders. In other words, you call people and 40 said, "Send me a subscription."

Of those 40 people, what—many of them may have been doing is not at all ordering the newspaper, but they may have been actually ordering the gift you were going to give them with the subscription.

Just like magazine sales, where if you sign up and prepay for a year's worth of a magazine, they will send you a clock or send you a stuffed dog or some kind of gifts.

An awful lot of people that are responding to that television ad or phone call or that direct mail campaign [254] basically want the clock or the stuffed dog or the gift, so a lot of them drop off because once they have gotten the premium, they are satisfied.

Some of them drop off because what they had was just a really good salesman who talked them into something that then when they got it, they really didn't want it.

Some people will drop off, because when the paper does come, they are still not satisfied with quality of the news coverage or coverage that they are receiving of their community or its advertising contents, or its delivery service, so they will quit because their expectations have not been met in terms of what they were told to anticipate.

And so what you see is of the 40 orders that you wrote, you have people that churn out, people that drop off and people that never wanted it in the first place, built into those 40 orders.

So what you are left with then is the one or two or five subscribers that you did indeed meet their expectations after you solicited and sold them a newspaper, and they then come in to replace the ones who had dropped off.

Unfortunately, a lot of the experience of newspapers is that you can't write the orders fast enough to be able to replace the people that drop off because these factors feed on each other and the churn and attrition rates become very difficult to replace as they start falling out [255] the bottom of the sieve.

Q You may have answered this question in response to the question from the Court a moment ago, but in case there is more here, let me ask:

Earlier in your testimony and in your report you described a variety of efforts that newspapers make to replace the subscribers that they lost on to maintain their markets penetrations.

Based on your experience what, if anything, would happen to a newspaper which failed to make those efforts?

A If you fail to make those efforts, your subscriber list would continue to decline and the subscribers would continue to drop off.

Your prospects for remaining a successful paid daily newspaper would be dim, because as that process would continue to happen, the increasing weakness of your newspaper's subscribers and your newspaper's paid circulation would quickly become evident to your advertisers, who would look not only at the circulation figures and penetration figures that are published from the Audit Bureau of Circulation, but would look around the neighborhood and see that fewer homes have the newspaper in front of their driveway or stoop.

So you would be putting—by letting this problem go and not dealing with it or not wanting to deal or trying [256] to sell subscriptions or retain subscribers, the subscriber list would continue to decline year after year, and you would be putting at risk the circulation revenues and also advertising revenues of the newspaper.

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Q If we look at the total number of subscribers, and you say for—say for Booth newspapers in 1977, they had approximately 460,000 subscribers, and maybe today they have the same number or even more, looking at those figures and based upon your expertise and your experience, would you say that that is a process that happens all by itself, of how would you response to respond to the notion that is what the Government is suggesting?

A The thought or concept that subscribers come to the newspaper all by themselves or that those numbers are evident from an automatic process is ludicrous based on my experience in the industry.

Prudent and reasonable newspaper operations have been spending increasing amounts of money trying to sell [257] subscriptions and retain subscriptions, on very much of an expectation that this is not an automatic process, and that it's difficult and becoming increasingly difficult to bring in those subscribers and maintain them once they are there.

I don't think subscribers automatically replace each other, nor do I think that there is an absent group of people out there waiting in line for newspapers.

It's a very difficult process of selling and meeting expectations and satisfying the customers that we have.

Q Now, also earlier in your testimony and in your report you described circulation sales programs.

Based upon your expertise, how do those kinds of programs, or how do the subscribers which are attracted through those kinds of programs where, say, a newspaper hires an outside sales force as opposed to using their paperboy, when they hire an outside sales force for a circulation sales program, how do the subscribers they get through that program compare to the regular, shall we say, seasoned subscribers which the newspapers have before they conduct that campaign?

A The evidence we have from markets where we have done and studied this issue quite intensively, suggests that the subscribers that are gained from hiring an outside sales force or outside boilerroom operations to kind of come in [258] and do the solicitation don't stay as long, first of all, in the newspaper.

They are much less likely to be resold, if you will, or come back to the newspaper as a single copy buyer, because in many cases you are dealing with those subscribers being brought in because of the premium or salesmanship or offering or free or the discounted kind of prices

that were offered to them on the phone or in the mail, so those subscribers don't stay that long. They don't have the same degree of readership in the newspaper.

When we ask on surveys, how much of the newspaper did you read, 100 percent, 75 or 50 percent, the subscribers to a newspaper tend to have a higher depth of readership, be reading more in that newspaper than do the people who were brought in, especially brand new subscribers who came in right after a very intensive or sales program who may only be reading Ann Landers or the comics and not gaining value from a newspaper. They are much more likely to drop out quickly and find it difficult to be resold.

In fact, the experience in the industry is that outside sales companies that come in and set up a phone room and go through the list, they may sell an awful lot of subscriptions, but there is also a higher probability that those new subscribers won't stay or they won't pay.

So what happens is that, they tell you on the [259] phone, yes, indeed, I will be happy to subscribe to the newspaper, but then after the newspaper comes, they don't pay.

* * * *

[261] Q Let me ask you one another question. This relates to a hypothetical that was presented to one of the other witnesses yesterday by the Government's attorney, and let me try to describe the hypothetical to you.

Mr. Grabowski was asked by Mr. Hrebiniak to suppose that on day one, and I maybe paraphrasing, but I will get as close as I can.

On day one all of the Booth newspapers were sold to a new publisher without any paid subscribers, and then on day two, you went out and solicited every household in all of the eight market areas, and you had to pay this sales force say $4.50 a piece, which for purposes of his question was the cost of such solicitations by outside sales forces, you would have to pay $4.50 a piece for each household they solicited.

And he suggested in his hypothetical that by doing that on day two, or I guess it was day three, not quite sure, you would have exactly the same 460 odd thousand subscribers that you had on day one or zero before you received the papers from the subscribers.

How do you react to the suggestion of that kind of scenario—

A Well—

Q —based upon your expertise?

A Well, first of all, based on my expertise, it's a very [262] strange hypothetical that anybody would buy a newspaper without the paid subscribers that go with it.

So that that is a difficult prospect for me to imagine, that you would sell a newspaper but say, no, we are not going to sell you the paid subscribers.

Q Have you ever seen somebody buy a paid circulation newspaper without paid subscribers?

A I have not seen anyone do that, no.

Q Ever heard of anything like that?

A No. Not to my recollection, no.

The—but given that improbable circumstance for a moment that a seller and buyer could agree on such terms, on the—on day two, at dawn of day two, when you went out and solicited, you put together the most massive phone room I can imagine to go out and call every household in the market, the probability that you would be able to reach all of the households and get the subscribers who were there on day one to say, oh, yes, don't worry, I will come back, that is a much lower probability after you severed the relationship and ceased providing them with the newspaper and service and meeting their expectations during that moment in time, than there would have been if you had not done it, of course.

The other concept that is difficult for me to understand is not only why one would want to do it, but how [263] long would it take to call every household in a market and be able to not only call into the household, but, A, reach somebody who is at home.

B, make the kind of sales effort or re-subscription effort and pitch that you would describe.

My guess is that it would take months to be able to do this, during which time you would be spending, in my experience, a lot more than four or $5, if that was the number you mentioned in the hypothetical. You would be spending a lot more than four or $5 per household to even make the contact.

You would also be without the circulation revenue that the subscribers would have been providing during that time period necessary to recontact them all.

And then the probability that all of them would come back is, to me, an impossible expectation. Some of them would not come back.

Q How can you say that?

Do you have any experience in measuring the ability to go out and get people to come back after there has been a termination of service?

A Absolutely.

A lot of the work that I was describing earlier under the headline of retention programs, has to do with calling former subscribers who cancelled or, for some [264] reason, you didn't deliver. There is also a—fault, sometimes that happens in the newspaper, not maintaining the qualities of service it should.

In calling former subscribers saying, "Would you please come back." So I have data and personal experience with looking at—in a lot of markets where former subscribers of very recent cancellations saying, "No, I won't come back. I didn't like the paper. I don't like the carrier. Never brought it on time. You let me alone for a week and then send me two bills," you know.

There are 100 variations, but in my exerience, you can call former subscribers who quit as recently as about a week ago or month ago, and they will not come back.

THE COURT: Is valuation part of your expertise, Doctor?

THE WITNESS: No, we don't do valuation.

THE COURT: Let me ask you this anyway and if it is not within your area, please do not hesitate to tell me that.

If somebody was sitting down to buy a newspaper that had paid subscribers, and the buyer and the seller were discussing what amounts should be attributable to that fact, the dealer would say it generates X number of dollars and the value is so much. In this case, there has been evidence of $60 million.

[265] And the buyer says, well, that is crazy, because if you didn't have these paid subscribers and I bought the newspaper, I would hire people and spend three or $4 million and be in the same position that you are in today. Why should I spend $60 million to buy what you have in the value of paid subscribers where I could go out and spend $4 million and be in the same position?

THE WITNESS: Uh-huh.

THE COURT: Is there merit one way or the other in that discussion?

THE WITNESS: If I were listening to that conversation, I would say to be able to go out and recreate the revenue generation power of the subscribers for three or $4 million would be a hell of a deal. I don't know how to do it for three or $4 million.

There is a lot more built into these subscribers' ability to benefit the newspaper business as a business than just their existence and they are not as easy to get back as some would believe.

There are long-standing relationships and meeting of expectations that go into what makes these subscribers beneficial to the newpaper and to the advertisers that provide the revenue and as well as the readers do.

I don't see that the numbers that would have been tossed around in the hypothetical situation make a lot of [266] sense to me.

THE COURT: All right.

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CROSS EXAMINATION

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[271] Q Now, you would agree, wouldn't you, that subscribers are at-will customers?

A I don't know what—tell me what an "at-will customer" is. I don't understand.

Q There is nothing legally binding them, is that it?

A I am still not—I don't know what "nothing binding them" means.

Q Well, Dr. Urban, because a subscriber is here today, doesn't necessarily mean they will be here tomorrow, does it?

A True. Because you have a subscriber today. They have—they can stay tomorrow, or they have the evidence of sometimes dropping off tomorrow.

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[294] Q This is the hypothetical where they don't have the subscription list, don't buy it, they lost it, what-have-you, and they try and contact the subscribers anew and call everybody in the area and you said some wouldn't come back.

Isn't it correct you said some wouldn't come back because the paper has failed to meet their expectations in some way?

A That is part of the reason some may not come back, but let me clarify.

Q Sure.

A In reasking the hypothetical, you used the term "subscription list," and we are not talking about the list.

I am talking about human beings that behave a certain way towards the newspapers, and if what you have are subscribers, a hundred human beings that on Friday expected to have the newspaper delivered, because they were subscribers to the paper, and then during the hypothetical sale to the seller, who didn't want to buy a paper without their subscribers, which is what doesn't make sense to me, if during the sale, the paper didn't come,

yes, you have [295] violated 100 human beings' expectations of what it was that newspaper represented.

The time period that I was referring to is the fact that you can't pick up the phone a day or two later and suddenly and instantly reask the whole market and magically have these subscribers come back because those subscribers have violated—you violated their expectations, you have damaged in some cases the relationship, you know, that they had of trust that the paper was going to get there 6:30 on their doorstep.

It's just also physically impossible to be able to regenerate that without building in enough time to make the phone calls, talk to the people.

So what is—I hope that is responsive to what you were asking.

Q I think it is. Let me sum up.

You are saying when you try and do it again the problem with the defeated expectation and disruption in the relationship between the paper and subscriber, is that what you are saying?

A No. I am saying an important part of why a lot of the subscribers you may have had on Friday of day one, when you do finally get to call them at great expense and finding them and contacting them, may not come back to the newspaper.

[296] Part of the reason is because of those violated expectations of service, part of the reason is because they may have found another competitor in their eyes equally good at providing them news or information or advertising information and, therefore, they have moved their subcription or moved their time or moved their attention or moved their behavior over to some other form when you were not there.

And the process of doing that would be so tremendously expensive to be able to get even back that portion of subscribers, that it would be an imprudent suggestion to imagine one would ever try to do that.

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[306] Q By "category," you mean the same types of expenses, right?

Now, I am the one confused of definition.

By "category," you mean they have sales staff, production staffs, printing process?

A Both have news rooms, staff writers. Both have graphic artists.

They both have categories of costs that are related in all of the departments of the business, save one, which is that the free paper does not have a category called circulation revenue, managers or collectors, or solicitors or billing office for circulation.

THE COURT: Let me see if I can help.

Assuming, if you can, that you had two newspapers serving the total community with identical circulation, one paid subscription and one free, is there any way that you could render an opinion as to whether the cost of one would be greater than the other?

THE WITNESS: If you—in the situation of an identical market with two identical circulations, my [307] estimate in this hypothetical, my estimate would be that if they both were striving to be read by readers, they probably would have very similar expenses, magnitude of dollars, very similar expenses for reporters, photographers, all of the people involved in creating the news editorial contents.

The cost of production are essentially the same, costs of advertising sales would be essentially the same, because they would be going after and competing for the same advertising people.

They still have to make—the free paper still has to maintain the quality and efficacy of its home delivery and distribution systems, so their costs would be essentially the same there. They wouldn't have the cost of going and asking people for money.

So given the same size operation, you are dealing with very comparable costs and magnitude as well as in structure of those various departments of the newspaper, be-

cause both of those two entities would be looking for the same thing.

They would be both looking to convince you as a resident of that community to read them and both trying to convince the same set of advertisers to pay them to be the vehicle of messengers that were designed to reach you.

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TESTIMONY OF LARRY D. BERKEY

(February 7, 1990)

DIRECT EXAMINATION

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[444] Q And what, in particular, was the question or questions which were put to you or DeLoittle & Touche Valuation Engineering Associates in connection with the matter?

A What was the fair market value of the subscribers of the Booth newspapers as of May 31, 1977?

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[448] Q Based upon your expertise, what conclusion did you and DeLoittle & Touche Valuation Engineering Associates reach with regard to the fair market value as of May 31, 1977 of the paid subscribers of the Booth newspapers?

A We concluded that the fair market value of the paid subscribers of the Booth newspapers as of May 31st, 1977 was $67,773,000.

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A As I stated earlier, we tried to place ourselves in the shoes of a buyer and seller, and determine what fair market value a property would exchange hands at.

It's generally-accepted valuation theory applied both in my experience in the valuation industry, as well as prior corporate jobs, that that value is determined by the net present value of expected future economic benefit, and [449] that is what the income approach does measure, and that is why I am of the opinion it is the appropriate measure to determine fair market value of the asset here.

Q What revenues and what costs did you attribute to the paid subscribers of the Booth newspapers as of May 31, 1977 in your valuation methodology?

A In looking at what revenues and what costs to include, we tried to look strictly at those revenues and

costs that are attributable or in addition to the assets' existence.

Specifically, we looked at free distribution newspapers and what costs they incurred and then paid subscriber newspapers, since that is the asset in question, that is in addition to a free distribution in the case of the paid subscriber newspapers, the only class of costs and revenues and costs which are, in addition, are the subscription revenues and the cost associated with collecting those subscription revenues.

Those are the additional costs, and the only additional costs and revenues and the only ones I have considered.

Q Why in utilizing that method did you not net out or subtract the costs—production costs of producing the newspaper and other similar costs?

A As I indicated earlier, there are newspapers, free distribution newspapers, in which all of those costs are [450] incurred.

They are incurred in the process of that newspaper doing its business, which is namely getting its economic business—I should say, there is another business, but there is an economic business of delivering the advertising revenue to readers.

And all of those other costs of production, delivery, are in those newspapers. Therefore, in a paid subscriber newspaper, the only additional costs and expenses are those I referred to earlier.

Q How, if at all, Mr. Berkey, would your conclusions change if you determined to allocate to this particular asset, certain additional expenses such as the production costs of producing the newspaper?

A I understand there has been a lot of discussion revolving around all the location of production costs and overhead, and while we are of the opinion that the method we used in our report is the best method, there is an alternative method, which is used in the valuation industry, in which revenues and costs are allocated, and we performed an analysis using that method, and we found

that the results of that analysis did support our conclusion as contained in this report, and if your Honor would like, I can get into some of the details surrounding that analysis.

THE COURT: Well, that is up to counsel.

[451] Q Could you summarize, Mr. Berkey, what that analysis was and what it showed?

A In that particular analysis in which we are doing an allocation, we start with an allocation of the revenues, again through discussions with industry experts and people in the industry, it is stated and all of the experts would probably agree in that area, that there are additional advertising revenues which are attributable to the existence of paid subscribers.

In the first step, we allocated revenues.

Secondly, we took all expenses, productions costs, delivery costs, overhead costs as well as a fair return on other assets and allocated those costs to those revenues to arrive at a conclusion of fair market value.

Q And did you come to a conclusion as to what that approach would or that method would—what value you would derive for the fair market value of the subscribers for Booth newspapers as of May 31, '77 using that method?

A Yes. Using that method and also perhaps had somewhat limited information.

We don't delve deeply into cost structure, therefore we allocated all costs.

I draw the differentation that there are substantial costs associated with acquiring new subscribers that we feel are not allocable to the existing subscribers. [452] We were not able to hold those expenses out, so we left them there.

In doing that and allocating all costs, including those costs, we concluded a value using that approach of approximately 61.5 million.

* * * *

Q Now, going back to kind of the bigger picture and I am trying to get through it quickly and not be too repetitious of previous witnesses, but why did you conclude that the income approach was the correct approach to use in valuing this asset as opposed to the other alternative basic approaches to valuation?

A Okay.

As I am sure has been covered before, and there are the three basic approaches of cost, market and income, and in looking at the alternatives, we concluded either that there were just not the information available or that it was impossible to identify those costs associated in this asset, and therefore a limited—eliminated those and, secondly, or I would point out that in an income producing asset, [453] which we are valuing here, buyers and sellers will look at the expected net future benefit as being the fair market value.

So, both from the point of view of the data for the other approaches either not being available or probably impossible to pull out, it has the advantage of truthfully measuring the economic benefit to the seller should he continue to hold it, and he wouldn't be willing to give it up for less and, likewise, the buyer being willing to pay for that expected future economic benefit.

Q Now, why, Mr. Berkey, in your expert opinion, is it appropriate to value an asset based on the income approach when the asset produces that income only as part of this ongoing enterprise?

A Again, we are looking at an ongoing business enterprise here, and we are trying to establish that fair market value at which an asset that is a part of that ongoing business enterprise would change hands.

So we look at that asset as it functions in the business enterprise and look at its contribution to that enterprise.

What additional contribution does it bring to the enterprise that fairly measures the fair market value of the assets in the ongoing business.

Q Are the evaluation principles that you have just [454] described really throughout your testimony thus fa[illegible]day, principles or theories or methodologies that you uniquely applied in this valuation exercise, or are they generally-accepted principles within the community of valuation experts?

A The principles are generally accepted principles in the valuation community and the specific method used in this instance is also generally accepted in the valuation community.

Q Can you explain for the Court whether based upon your expertise, you reached any conclusion as to whether the paid subscribers of the Booth newspapers were assets separate and apart from the goodwill of those newspapers?

A Yes. As a valuation expert, did reach a conclusion.

Q And what was the conclusion?

A That they were, indeed, separate and apart from goodwill.

Again, looking at it as a valuation expert, since I am not a legal expert and part is a question of law, and from a valuation point of view, we look at it and say, can I separate out the asset and I separately identified the asset.

Can I establish a value for that asset and additional income stream, net income stream attributable to the asset, as well as, does that asset have a reasonable [455] determinable life?

We have dealt with the issue of we are of the opinion that these subscribers are identifiable. I don't know if that is—but they being valued.

We have identified the additional net income stream available to that asset, and SRI has prepared a report in which they have independently established the reasonable determinable life as modified by the stipulations.

We have met those tests, which as a valuation test is—we apply to say is the asset separate and apart from goodwill.

THE COURT: Going back to your opinion as to the value, is that opinion in any way conditioned upon the fact that this asset is part of an ongoing operation?

THE WITNESS: We have measured its value as part of an ongoing operation, yes.

If it is sold in what I would call in liquidation, it's not unlike the printing press.

If the printing press is sold separate from the business, so to speak, sitting in the middle of a street, it has a value which is distinctly different from part of the going enterprise, where it is proper to include and has been included in prior judicial decisions, where the installation turnkey value, things such as that, are included as part of the value and use, as opposed to value being sold separate [456] from the business.

Likewise, for the paid subscribers, they do have a value as part of a going concern which is different from being sold separate from the business.

* * * *

[458] Q What, Mr. Berkey, in your expertise, is the appropriate method of determining of the value of the goodwill of an enterprise such as the Booth newspapers?

A In that it would be the residual method from the business enterprise, and in that you would have the value of the entire business enterprise and deduct the value of all of the other identified assets, such as, working capital, tangible assets and other identified intangible assets, and the goodwill would be the residual.

Q Why, based upon your experts and expertise, is that the correct method for valuing the goodwill of such an enterprise?

A It is the generally-accepted valuation methodology. It is currently dictated by treasury regulations and I also believe it to be the IRS's position in terms of the correct method to value goodwill.

Q How do you come to know that that is the correct or the IRS's view of the correct method?

A I can base it upon an actual experience in which—

MR. HREBINIAK: We will stipulate the residual method is the proper method.

THE COURT: So stipulated.

* * * *

[459] Q Based upon your expertise, Mr. Berkey, how would you respond to the Government's contention that the paid subscribers of the Booth newspaper are not the appropriate asset to be valued, but that if any asset should be valued, it should be the subscription lists of the papers?

A Similar to our discussion a little bit ago, to me, as I understand what subscription list is in this scenario, it is that asset totally separate and not in any way associated with ongoing business.

It's a liquidation value similar to the press being separated from the business, and none of the value attributed to its part of being part of a going concern.

Therefore, we should not be valuing the subscription. It's under the wrong premise of value. It's a premise of liquidation other than a premise of going concern.

Therefore, subscription list is, as I understand it to be used in that term, is not the proper asset.

THE COURT: Of course, if you were buying the opportunity to make delivery to the current subscribers, you, as a matter of fact, would have to have the list. The list would have to be part of the purchase, would it not?

THE WITNESS: It would, yes, normally be part of that—the list would be and I will call it a subset perhaps, the value of the paid subscribers.

[460] THE COURT: It is a means by which you would identify the paid subscribers?

THE WITNESS: Correct.

Q Based upon your expertise, how would you respond to the Government's contention that the—I use the term advisedly—the real assets of value in this case is what is called the customer structure or the subscriber or sub-

scription structure of the Booth newspapers, and that that asset essentially lasts forever, or sometimes what is called a self-regenerating asset?

A I guess I am somewhat of the opinion that not much lasts forever, and in terms of a customer structure, again, I can point to my prior experience, which I mentioned Scott Paper, Heublein, H-e-u-b-l-e-i-n—I hope I don't offend them, but something like that, I may have misspelled it—in which the consumer products company quite often is involved in strategy, will look at a particular brand and decide to call and remove the support and almost inevitably is that the brand declines, volume declines.

In that particular instance it doesn't regenerate itself.

I think we are in a very similar situation here, that unless the newspaper spends money on that asset, and involves themselves in that asset, it also would decline, it would be a wasting asset, and it is not self-regenerating.

[461] Q In your valuation exercise, were you valuating a customer structure or the specific subscribers as of a specific date in time?

A It was the specific subscribers as of May 31st, 1977.

Q If one were to carry your analysis to its logical conclusion, would that mean that the customer structure of all businesses would be depreciable?

A No.

As a matter of fact, I think earlier I talked about how in this particular instance there are some that we have not stated are deductible when I talk about consumer product companies, where we cannot identify the customers necessarily, can't value them, because we don't know their buying habits or anything like that, we would not say that those are amortizable.

But more specifically here, there are single copy customers where we have not been able to get their behavior, know-how, either in terms of living or how they spend money. They might be just as loyal.

I am sure there are others who buy it every day religiously. But for the specific single copy sales readers and also the advertising customers, who are really customers of the paper, we have not said, if we want to use that term, that part of the customer structure is amortizable.

So in a general sense, no, and specifically here, [462] no. We are not saying that all parts of the customer structure are amortizable, only those which we can separately establish a value, and there can be established a reasonable determination life.

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TESTIMONY OF WERNER VEIT

(February 7, 1990)

DIRECT EXAMINATION

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[477] Q How would you describe the business of the Booth newspapers, Mr. Veit?

A Well, I would say that our business is to produce a product that offers news and advertising information to readers and the means for advertisers to get the attention of those readers.

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[489] Q What, if any, relationship exists between the fact that a newspaper is a paid circulation newspaper and the existing rates that the newspaper can charge?

A Well, we generally think we can charge more for paid circulation, if we have paid subscribers, because not only can we prove that—that the reader actually wanted the newspaper, but perhaps just as important, who those people are.

The advertiser tends to be very much interested not just in raw numbers, but where do these people live.

In fact, much of the interest of advertisers today is not so much in community but in zip codes. They really don't want to know how many subscribers do you have in town X.

What they really want to know is, what do you have in zip codes 49506.

The reason for that is that the marketing information that retail stores tend to have, has been collected by zip codes. I think that is short-sighted, but [490] that is what happened.

So it's only because we are able to track paid subscribers that were able to show what our—I should say what our penetration is in a given zip code as well as a given community.

So—it helps us sell advertising and it—it—advertisers are willing to pay some kind of premium. Hard to tell what it is for paid circulation versus free.

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Q What is the significance of single copy sales to a newspaper with a paid circulation base?

A Still income, and we like having it.

Q How does that differ from paid subscribers?

A Paid subscriber is predictable. We can—the cash flow is—is—is predictable. We know what will come in. [491] For reasons that I am not sure I understand, most of our customers are very good about paying their bills, so, you know, we know exactly the money coming in and we don't know what is coming in from the single copy sales.

So from a cash flow point of view—in fact—in fact, we are even willing to charge less for having the paper delivered to the house than we are on the street corner, because of that predictability and because of that value.

If you want to get the paper delivered to your house seven days a week, you get a substantial discount over buying it on on the street corner, even though we have the expense of getting it to you.

Q In average terms what percentage of the total circulation of Booth newspapers is comprised of its paid subscribers?

A Today?

Q Yes.

A About 80 percent.

Q And what was the comparable percentages in May of 1977?

A About 85 percent.

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[497] Q Have you at any time undertaken to determine the total costs involved in—which Booth has incurred really in trying to replace subscribers who leave?

A No.

Not in those terms because so much of what we do and all is wrapped up with trying to be an important, necessary institution for new people as well as ones we already have.

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TESTIMONY OF DONALD E. NEWHOUSE

(February 7, 1990)

DIRECT EXAMINATION

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[517] Q Now, was the fact that the Booth newspaper group had paid subscribers at all a factor in your determination of whether to purchase the stock?

A It was definitely a factor when we made our study of Booth, we reviewed the published information about its circulation.

We also talked to the then CEO of Booth about its circulation and made a determination that it had a substantial number of paid subscribers, and that became an important element in our thinking about Booth and did affect our evaluation of Booth.

Q So the existing—am I correct that the existence of paid subscribers and the number of them played a factor in your decision to acquire the company?

A It did.

Q And were those two factors also part of your decision in [518] determining what price to pay for the stock?

A Excuse me.

Did you say "two factors"?

Q Yes. The existence of paid subscribers and the number of them.

A Yes.

It had—it did have a—it was a factor in a decision as to what price to pay.

Q Now, did you at that time based on your experience with the other Newhouse publications and your investigation during the period of the acquisition, determine what percentage of the total circulation was of paid subscribers and the revenue was of paid subscribers and what percentage of the revenue came from advertising?

A Yes. We had information that Whitney had us do what the total circulation revenue was and what the total advertising revenue was.

Quite traditional, about 80 percent advertising revenue and 20 percent circulation revenue, and we had information from public sources that showed many paid subscribers Booth had, and in our discussions with the then CEO of Booth we ascertained that what we would expect as to the division of circulation revenue between paid subscribers and single copy was, in fact, what the division was.

Q And was that 80-20, 80 percent of the total revenue from [519] advertising, and 20 percent from circulation and subscribers and single copies, was that in conformity with your experience generally throughout the country at that time?

A Generally.

It varied between major metropolitan market newspapers such as the Star-Ledger would be and papers of the size of the Booth group, but generally the 80-20 would be normally what would be expected.

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PROCEEDINGS ON ORAL MOTION TO DISMISS BY COUNSEL FOR THE UNITED STATES

(February 7, 1990)

[526] MR. HREBINIAK: Yes, your Honor.

Pursuant to Rule 41(b) of the Federal Rules of Civil Procedure, the defendant moves for involuntarily dismissal of plaintiff's case on the ground that under the facts and law, under the facts presented by plaintiff and the applicable law, that plaintiff has not carried its burden of proof.

First, plaintiff clearly has the burden of proof. Its burden includes the burden of showing that the asset that they were trying to depreciate had a value, that that value is separate and apart from goodwill, and then if it were, that it had a ascertainable useful life.

I believe that the facts have shown that the asset is, as a matter of fact and as a matter of law, not separate and apart from goodwill, the asset as they have characterized it, that in fact the asset has been valued in a way that does not give credibility or weight or substance sufficient to carry their burden of proof, that there were severe problems with the valuations, as we have pointed out in the trial and, finally, that in fact, plaintiffs have not even come close to proving an ascertainable useful life.

They merely showed that it would be useful for the newspapers for some 40 to 50 years or perhaps even further. There was never any connection made between Mr. Glasser's report and in fact a useful life.

[527] And I think that under the case laws—the case law, number one, there have been the assets themselves, there has been no introduction of any evidence to show in fact it was an intangible asset, the type of which is normally depreciated under all of the cases.

There is no contract, there is no copyright, there is no patent. There is only a relationship.

I think the evidence was clear that this relationship was strictly the one between the customer and the paper,

and it was the likelihood that the customer would return to the paper.

They isolated a finite group of customers and proved statistically that this finite group of customers would disappear and eventually no longer be subscribers, but that does not carry the burden of proving that that is not merely the subset of goodwill.

Any part of goodwill can be broken apart and subsets of goodwill can be had.

The burden of proof was to prove that this asset was separate and apart from goodwill, that the relationship was separate from the mere relationship of a customer coming back to the place of business.

And as far as the evaluation, we—without getting into it more specifically, I think—

THE COURT: Let me try a hypothetical on you that I [528] have not done before.

Do you distinguish, if we go back to the real estate analogy between month-to-month tenants and tenants on fixed leases,—

MR. HREBINIAK: Uh-huh.

THE COURT: —would you say that you could not use the income approach, because month-to-month tenants are not committed to stay for any fixed period of time?

MR. HREBINIAK: The asset would have, since there was no contract or no lease, there was a tenancy at will. I can't imagine how the owner could or for how long he could predict that someone would stay in the apartment.

Again, I am sure a statistical study could be done of a group of people, and they can say on the average they stay five years or ten years.

THE COURT: Before we get to whether it has a fixed or determinable life, you suggested in some of your arguments that the reason you cannot distinguish this from goodwill is because there is no firm commitment from the subscribers to continue buying, not that in reality they may continue, but there is no contractual obligation.

Do you say that that is an essential which the plain-

tiffs must prove that there is some firm commitment by one or more consumers?

MR. HREBINIAK: Yes.

[529] I would have to say that at least there is—there has to be some sort of firm commitment.

THE COURT: Then I go to my month-to-month tenant, where obviously there is no commitment on the part of the tenant to continue the relationship, do you say in evaluating that real estate, you would not take into consideration the rent being generated and the expectation that they would continue?

MR. HREBINIAK: Absolutely not. That has great value.

I think one of the misconceptions is that the Government here is not contesting the value of customers.

And in that case we would not at all contest the value to a buyer of that building of the fact that this building has been rented continuously and that the prospects in the future are good.

But if they are merely month-to-month tenants, and he has to be very careful because it is probably the goodwill of that building that is keeping him there, the likelihood that they will return.

He doesn't mean that he won't pay as much for the building.

THE COURT: But the point is, if you include the month-to-month tenant income, using the income approach and you arrive at a value of the building, that would then be [530] the basis for the depreciation, would it not?

MR. HREBINIAK: An excellent complicated question, and I am afraid I am falling short.

THE COURT: Think about it. It is late in the day.

Let me say this in respect to the motion and I will not require any response.

I will reserve on the motion and I will decide it after the conclusion of the Government's case.

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TESTIMONY OF JOSEPH P. BANIEWICZ

(February 8, 1990)

VOIR DIRE

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[569] Q Now, your report is a valuation of lists only, subscriber lists. Isn't that correct?

A Correct.

Q It's not a valuation of subscribers—of the paid subscribers of the Booth newspapers as of May 31, 1977, isn't that correct?

A Correct.

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DIRECT EXAMINATION

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[593] THE COURT: Let me see if I understand it.

Let's take a weekly. Suppose you have a free weekly and a paid weekly in a community, each for 30,000 subscribers.

Is it your opinion that the value of the list in both of those instances would be the same, that you would not have differentiated between those subscribers who were paying $5 a week to those who were paying nothing?

THE WITNESS: The amount that a paid subscription is—is—is worth, is the goodwill or preference or the custom that that customer has with the paper.

Now, a free paper, it's just delivered at the door. You don't know if there is a preference or not.

In a paid weekly there would be a value to the paid, but that would also be—be—be included in [594] goodwill, the fact that that anybody had a position with those customers that they were actually willing to pay for the weekly paper.

THE COURT: In answer to my question, you would say that in evaluating the subscriber list, using your term, for the free weekly and paid weekly, same number

of subscribers, that the value would be the same, assuming it is the same community, same subscribers?

THE WITNESS: There isn't a subscriber list because there is no collection of subscriptions.

THE COURT: All right. Delivery list we will call it.

THE WITNESS: There is probably a delivery list in neighborhoods, but I don't think the households are identified. Just goes down the street and—

THE COURT: There has been some testimony that advertisers even with free papers target certain areas and are interested in certain areas, but taking my hypothetical, one is free, one paid, in your opinion, there would be no difference if you could identify the subscribers in both instances?

THE WITNESS: In the hierarchy of weeklies, a paid paper is worth more because it has a higher level of going concern and goodwill, so that is an element of value in the fact that the advertiser understands that there are people [595] that are willing to pay for it, if they are willing to pay for it. They are going to read the paper—

THE COURT: Does it make the list more valuable?

THE WITNESS: There is no list in free circulation. The list is just a tool. That is just a list in facilitating delivery—the delivery to the identfied subscribers in a paid situation.

THE COURT: What about catalogs, aren't they aimed at designated subscribers even though they come free?

THE WITNESS: Yes.

I think I identified the cost in the paid subscriber of establishing that list.

I mean I am putting a value on the list. There is a value to that.

THE COURT: But my question is: Is the value different if the person is paying for the magazine or getting it free?

Is there any difference in your valuation of the subscriber list?

THE WITNESS: If they are paying?

THE COURT: Yes.

THE WITNESS: In terms of the list, no.

THE COURT: All right.

THE WITNESS: There is additional value, but it's not attributable to the list.

[596] It's attributable to the preference of the consumer to read the paper. In a paid situation, it's going to have a higher goodwill value, because the prevalent—the preference of the customer to read the paper is evidenced by the fact that he is paying for that ability to read it, as opposed to a free list where he is not paying anything, but that is different from the list.

THE COURT: Suppose—the Houston case involved, did it not, the acquisition of a newspaper with no expectation of continuing its operations, but making use of the list of subscribers, right?

THE WITNESS: Well, it was sold to a surviving paper which was going to use it in the going concern.

THE COURT: If you were just buying a subscriber list for the purpose of making a solicitation, do you mean that a subscriber list of people who get something free as opposed to those who pay for it, has the same value, assuming you were not going to continue the operation of a magazine or newspaper?

THE WITNESS: First of all, a newspaper—in a free distribution newspaper they are just distributed to the general area.

THE COURT: That is why I said the magazine.

THE WITNESS: It's different from the magazine. That is a different question.

[597] The economics of competition and having a franchise are different.

That list may be very valuable in terms of selling it, because you targeted people in a very competitive environment that would be—but in terms of the free versus paid circulation, the paid organization is worth more, but the value goes into the customer relationship that the customer has the preference to read and the paying for

the paper is a stronger evidence of that preference and, therefore, that relationship is worth more, but that relationship is the goodwill.

The list is just a tool, the names and addresses, and the thing that facilitates the delivery to the paid customer. It's not the customer relationship.

THE COURT: All right.

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[621] Q —how did you describe the assets you were valuating?

A It was the subscription list which was the names and addresses of paid subscribers which facilitated the continuous and regular delivery of the paper to the subscribers.

Q Did you understand that the plaintiff used a different asset?

[622] A Yes.

Q And did you consider doing another evaluation?

A No. Because conceptionally I identified what they identified as being part of goodwill.

Q Okay.

Let's see.

Based on the cost approach, and based on your expertise and your background, training and experience in investigation, are you able now to express an opinion as to the fair market value of the subscriber lists of the Booth newspapers as of May 31st, 1977?

A Yes.

Q And what is that opinion?

A That the subscription lists were worth $2,296,763.

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CROSS EXAMINATION

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[637] Q I want to ask you this: The marginal subscribers are harder to get, it costs more to get them, to entice them into a new subscription, right?

A Correct.

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[638] Q Now, let me ask you to step away from this valuation exercise for a minute and talk to us about valuation concepts.

You heard Mr. Grabowski's testimony sometime earlier in the week, I can't tell you what day it was, but it was probably Monday, when it was direct testimony, when he talked about the fact that cost is an indicator of value, but in his judgment sometimes cost does not reflect value.

Do you remember that part of his testimony?

A Correct.

Q And do you remember that he used the example of a company that—that belonged, I think, to his uncle and he hired a young chemist right out of school, and he discovered some new process and they patented it, and the cost of creating the patent was really very low, but the value to the company, because it could be licensed or because it could be used, was very high. Do you remember that?

A Correct.

Q Would you agree in that situation that the cost was not a good indicator of value and—just there was not a good link between cost and value?

[639] A Yes.

Q Now, in your mind, as I understand it, you said you discounted your cost because it's easier to get the loyal subscriber or the seasoned subscriber, or whatever we call them, the regular subscriber from the costs that you had to work with, which were the costs of getting the marginal subscriber. Is that correct?

A Correct.

Q Now, you also said, as I recall, both in your report on page 24 and in your testimony in your deposition, that marginal subscribers are less valuable than existing or regular subscribers, isn't that right, because they have a lower retention rate?

A Correct.

Q And you said that in your report, didn't you?

A That is correct.

Q And you said it in your disposition, and you said it—you believe it today, right?

A In terms of the value, isn't the value—when I refer to "value," isn't the value that they are on the subscription list.

That value is the value of the relationship between them that would be included in goodwill as opposed to the subscription list.

Q But the total value of subscriber X, of the subscriber [640] who has been with this paper for ten years and will stay for ten more is a lot more than the value of Mr. Y, who they had to beat over the head to take a subscription and leave in a month, right?

A You are absolutely correct.

Q Okay.

And a buyer is going to want the first subscriber more than the second, isn't he, isn't he?

A Yes.

Q Okay. Because he is worth more, right?

A Right.

Q I am not talking about where you—what box you put it in, whether you call it goodwill or something else, he is more valuable, right?

A Correct.

Q And he is more valuable to the seller and he is more valuable to the buyer. Isn't that correct?

A Correct.

Q Now, so cost doesn't always equal value because the marginal subscriber cost more but is worthless, isn't that right?

A In terms of the—

Q I don't care about terms.

A In terms of the subscription list depends what you are looking at.

[641] Q I am talking value.

MR. HREBINIAK: Objection. Mr. Turkus is interchanging value. If he would specifically refer to what value he means, the value of the entire business as a going concern or the value of the subscription lists.

Those are two obvious things, and if he would ask the questions in those contexts, there would be no confusion.

THE COURT: I think he made it clear he was not asking for any allocation now, just talking value in the abstract. Is that correct?

MR. TURKUS: Absolutely.

THE COURT: With that understanding, can you answer the question?

THE WITNESS: In terms of total value, the value of the loyal subscribers—if you would include him—if you would include the value of the subscription lists and the goodwill, the amount of value between the two would be greater in the loyal subscriber in the combination of the two.

But in the list, it's just getting your name on there and getting the address, so the company knows where to deliver the paper.

• • • •

[643] Q Now, if you are going to determine value there, you just finished telling me the seasoned subscriber is a whole lot more valuable to everybody, buyer, seller and operator than the marginl subscriber, right?

A Right. And if you couldn't possibly put that relationship into goodwill—

Q I didn't ask you that. I just said it's more valuable, isn't it?

Forget about where you put the value. It's more valuable, isn't it?

A Yes.

Q And the cost approach that you used tells us and tells the Court that the marginal subscriber is the more expensive, doesn't it?

A Correct.

Q So if there is something about pure analysis that puts a [644] higher cost value on the less overall valuable subscriber, wouldn't you agree?

MR. HREBINIAK: Objection. Is this a continuing assumption?

THE COURT: Yes.

MR. TURKUS: In the context of that hypothetical yes. I apologize.

A I think what I am saying is that the cost of getting that marginal subscriber to be on the list takes more solicitation effort, is a costlier process and is the thing, if you are approaching the subscription list, makes it a higher cost.

• • • •

Q Mr. Baniewicz, forget about what basket you put it in.

In terms of overall value to the enterprise, value is part of an ongoing enterprise.

The seasoned subscriber is more valuable to the buyer, seller and operator than the marginal subscriber?

A Yeah.

Q Your analysis on the cost approach you used places a higher cost on the marginal subscriber and under your [645] analysis, a higher value on the marginal subscriber, does it not, in whatever basket you put it?

A It puts a higher cost in getting that subscriber on the subscription list.

Q You say that is his value, don't you? You equate cost with value?

THE COURT: Do you want the question repeated?

A In terms of getting him on the subscription list, yes.

Q That is the total value you put on the subscriber in your analysis, you say the other value goes into goodwill, but you don't value that as a separate asset, right?

A No. I—I don't value that in terms of the subscription list.

I mean, I recognize what you are saying is paid subscriber and you are calling something that I would identify as the relationship between the subscriber and the company and desire to take the newspaper.

A seasoned subscriber is more valuable to the company than one that is a marginal subscriber, but that doesn't

mean that if you are going to just reproduce the list, that the marginal cost of getting people that are not sure if they are going to take the paper is going to be higher, and is going to be—if you look at just the lists, which is the names and addresses of the subscribers, that is the asset that enables the company to deliver that paper on [646] a continuous and regular basis. That is the value of the subscription list as opposed to this seasoned customer relationship of a seasoned subscriber which is part of the asset of goodwill.

Q You said—

A Correct.

Q All right.

Now, you say that the subscription list is evidence of the relationship, right, didn't you?

Isn't that your direct testimony?

A All it is is a tool for the company to—I think what I have said is—I am not quite sure I put it in those terms.

I think I said, it is the subscription list which is the names and addresses of the subscribers, which enable the company to deliver the paper to its subscribers.

Q And the names and addresses are evidence of the relationship, are they not?

Didn't you say that before in your direct testimony?

A Yes, it's evidence, but that isn't—

Q It's a simple question. Let me ask you again and ask you to answer yes or no.

Are the names and addresses evidence of the relationship?

A Yes.

[647] Okay.

And you would agree that the seasoned subscriber relationship is more valuable to the enterprise than the marginal subscriber enterprise, wouldn't you?

A Yes.

• • • •

[666] Q Mr. Baniewicz, as I understood your deposition and this is a different topic, it won't be nearly as difficult for us to deal with.

As I understood your deposition testimony, you said if in the newspaper incidence, no more peas and peaches, in the newspaper example, if the subscriber had 20 year contracts, then you could and should use the incremental income approach to value and depreciate those contracts or subscriber relationships. Is that correct?

A Yes. I think you would have to look at your definition of income, though.

An income in that case, if—would be more like a lease.

If you had people contracted for twenty years, you would definitely have a useful life, so that wouldn't be a problem.

• • • •

TESTIMONY OF ARTHUR SHENKIN

(February 8, 1990)

VOIR DIRE

• • • •

[687] Q Let me ask you about—you did in your report instead a cost based valuation of the subscription list. Isn't that [688] right?

A Yes.

Q That was a subscription list, not subscribers?

A Yes.

• • • •

DIRECT EXAMINATION

• • • •

[713] What was the fair market value that you concluded for the asset that you valued?

A $1,250,000.

• • • •

CROSS EXAMINATION

• • • •

[715] Mr. Baniewicz I think would tell you that marginal subscribers are harder to attract as subscribers, because they have less interest in subscribing than seasoned subscribers.

Would you agree with that concept?

A Yes.

Q So is it harder to—do you agree with Mr. Baniewicz that it is harder to attract marginal subscribers to entice them into subscribing?

If you took two hypothetical potential subscribers, one who had the characteristics of a marginal subscriber and the other who had the characteristics of a seasoned subscriber, and you wanted to attract them to become new subscribers, would it cost more—would you agree with

Mr. Baniewicz it would cost more to attract the marginal subscriber?

A Yes.

• • • •

[719] Q Mr. Shenkin, would you agree with Mr. Baniewicz that the seasoned subscriber, because he will stay longer, brings more value to the total enterprise than the marginal subscriber who will drop off soon?

A Yes.

• • • •

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

Civil Action No. 88-4836-HLS

Honorable H. Lee Sarokin

NEWARK MORNING LEDGER CO.,
AS SUCCESSOR TO THE HERALD COMPANY,
Star Ledger Plaza, Newark, New Jersey 07101,
Plaintiff,

vs.

THE UNITED STATES OF AMERICA,
Defendant.

INTERIM ORDER

WHEREAS, this matter was originally brought before this Court on a complaint filed on November 9, 1988, in which the Plaintiff, Newark Morning Ledger Co. ("Morning Ledger"), asserted a right to a refund of federal taxes and interest paid for taxable years 1977 through 1980; and

WHEREAS, Morning Ledger's claims were based upon a number of asserted errors by the Internal Revenue Service in the processing of the tax returns of The Herald Company ("Herald"), a predecessor in interest to Morning Ledger, including the following (1) erroneous determination of the total adjusted basis in the assets acquired by Herald in the liquidation of Booth Newspapers, Inc. ("Booth") into Herald which occurred on May 31, 1977; (2) erroneous determination of the fair market values of certain of the assets distributed in the liquidation, namely, Booth's stock in Parade Publications, Inc., "going concern value," newspaper subscribers, and goodwill; (3) erro-

neous interpretation and application of the law with respect to how total adjusted basis is allocated to the property distributed in liquidation, leading to an incorrect determination of the adjusted basis in each of the assets acquired by Herald in the liquidation of Booth; and (4) erroneous determination that the values attributable to "going concern" and newspaper subscribers were non-depreciable; and

WHEREAS, in an effort to reach a partial settlement of these disputes between the parties, on October 12, 1989, Morning Ledger proposed a partial settlement of the issues to the United States; and

WHEREAS, the Internal Revenue Service has informed counsel for the Government that it finds the partial settlement proposed by Morning Ledger to be acceptable, and that it does not choose, nor has it authorized the counsel for the government, to litigate the issue concerning the inclusion in the adjusted basis of interim earnings and profits due to depreciation recapture; and

WHEREAS, the Government's position is consistent with the law as stated by the Tax Court and the Third Circuit governing the allocation of basis to assets acquired in liquidations such as that in this case; and

WHEREAS, counsel for the Government is unable to indicate to the Court today the Government's final position, either accepting or rejecting the proposed partial settlement despite numerous representations to this Court that final action by at least the Justice Department would occur prior to the scheduled trial date;

NOW, THEREFORE, it is on this 8th day of February, 1990 hereby

ORDERED, that Morning Ledger shall not be allowed any depreciation deduction for the going concern value of the Booth newspapers acquired in the liquidation on May 31, 1977; and it is further hereby

ORDERED, that Morning Ledger shall only be allowed an additional allocation of basis to the assets acquired in the liquidation of Booth in the amount of $14,176,000 pursuant to § 1.334-1 of the Treasury Regulations; and it is further hereby

ORDERED, that the fair market value of the Stock of Parade as of May 31, 1977, is determined to be $100,000,000; and it is further hereby

ORDERED, that the assets acquired by Herald in the liquidation of Booth are found to have the following fair market values and adjusted bases as of May 31, 1977:

Asset	Value	Basis
Cash & Equivalents	$ 15,617,042	$ 15,617,042
Securities	37,249,852	39,134,189
Accounts and Notes Receivable	15,046,899	15,046,899
Master Repurchase Agreements	3,100,000	3,100,000
Deferred Charges & Deposits	323,944	340,331
Inventories	3,435,627	3,609,423
Land	4,658,885	4,894,561
Land Improvements	1,721,959	1,809,067
Buildings and Improvements	21,350,237	22,430,269
Production Equipment	17,109,130	17,974,620
Computer Hardware	1,300,435	1,366,219
Furniture & Fixtures	880,775	925,330
Office Equipment	731,195	768,184
Autos & Trucks	234,489	246,351
Stock of Parade	100,000,000	105,058,644
Computer Software	1,658,000	1,741,872
Newspaper Subscribers, Going Concern Value and Goodwill	89,578,685	94,110,152
	$313,997,154	$328,173,154

and it is further hereby

ORDERED, that Morning Ledger is or may be entitled to certain refunds of taxes and interest solely by virtue of the foregoing paragraphs of this Order, and the parties are hereby directed to prepare a Stipulated Order for signature by this Court based upon agreed-upon calculations of such refunds of taxes and interest due, as set

forth in paragraph 31 of the Final Pretrial Order in this matter; and it is further hereby

ORDERED, that this order shall be merged into any final order and judgment entered in this proceeding.

/s/ H. Lee Sarokin
HONORABLE H. LEE SAROKIN

Dated: February 8, 1990

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY

Civil Action No. 88-4836-HLS

THE HONORABLE H. LEE SAROKIN

NEWARK MORNING LEDGER CO.,
AS SUCCESSOR TO THE HERALD COMPANY,
Star Ledger Plaza, Newark, New Jersey 07101,
Plaintiff,

v.

THE UNITED STATES OF AMERICA,
Defendant.

JUDGMENT

[Filed May 25, 1990, Entered on Docket May 31, 1990]

In accordance with the Opinion filed by the Court on April 3, 1990, judgment is hereby entered in this action in favor of Plaintiff Newark Morning Ledger Co. and against Defendant United States of America for a refund of federal income taxes and interest erroneously, unlawfully, and wrongfully assessed and collected in the following amounts for the years indicated:

1. For calendar and taxable year 1977, judgment is entered for Plaintiff against Defendant for refund of federal income taxes of $2,645,442, for refund of interest previously paid of $2,778,479, for a total amount of $5,423,921, plus interest from the date of payment of such amount as provided by law.

2. For calendar and taxable year 1978, judgment is entered for Plaintiff against Defendant for refund of federal income taxes of $2,041,903, for refund of interest previously paid of $2,070,793, for a total amount of

$4,112,696, plus interest from the date of payment of such amount as provided by law.

3. For calendar and taxable year 1979, judgment is entered for Plaintiff against Defendant for refund of federal income taxes of $2,013,154, for refund of interest previously paid of $2,283,242, for a total amount of $4,296,396, plus interest from the date of payment of such amount as provided by law.

4. For calendar and taxable year 1980, judgment is entered for Plaintiff against Defendant for refund of federal income taxes of $1,921,080, for refund of interest previously paid of $1,790,911, for a total amount of $3,711,990, plus interest from the date of payment of such amount as provided by law.

This judgment hereby incorporates the Interim Order entered by the Court on February 8, 1990, and thus resolves all claims between the parties. This judgment shall be deemed a final and appealable order in all respects as provided for in Rule 54(a) of the Federal Rules of Civil Procedure.

/s/ H. Lee Sarokin
H. LEE SAROKIN
U.S.D.J.

Date:

I hereby consent to the form of this Order.

UNITED STATES OF AMERICA

By: /s/ Gregory S. Hrebiniak
GREGORY S. HREBINIAK, ESQUIRE

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY

Civil Action No. 88-4836-HLS

THE HONORABLE H. LEE SAROKIN

NEWARK MORNING LEDGER CO., AS SUCCESSOR TO THE HERALD COMPANY, Star Ledger Plaza, Newark, New Jersey 07101,
Plaintiff,

v.

THE UNITED STATES OF AMERICA,
Defendant.

AMENDED JUDGMENT

[Filed June 4, 1990, Entered on Docket June 7, 1990]

In accordance with the Opinion filed by the Court on April 3, 1990, judgment is hereby entered in this action in favor of Plaintiff Newark Morning Ledger Co. and against Defendant United States of America for a refund of federal income taxes and interest erroneously, unlawfully, and wrongfully assessed and collected in the following amounts for the years indicated:

1. For calendar and taxable year 1977, judgment is entered for Plaintiff against Defendant for refund of federal income taxes of $2,645,442, for refund of interest previously paid of $2,778,479, for a total amount of $5,423,921, plus interest from the date of payment of such amount as provided by law.

2. For calendar and taxable year 1978, judgment is entered for Plaintiff against Defendant for refund of federal income taxes of $2,041,903, for refund of interest

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4. For calendar and taxable year 1980, judgment is entered for Plaintiff against Defendant for refund of federal income taxes of $1,921,080, for refund of interest previously paid of $1,790,911, for a total amount of $3,711,990, plus interest from the date of payment of such amount as provided by law.

This judgment hereby incorporates the Interim Order entered by the Court on February 8, 1990, and thus resolves all claims between the parties, which were the subject of this action. This judgment shall be deemed a final and appealable order in all respects as provided for in Rule 54(a) of the Federal Rules of Civil Procedure.

/s/ H. Lee Sarokin
H. LEE SAROKIN
U.S.D.J.

Date: June 4, 1990

I hereby consent to the form of this Order.

UNITED STATES OF AMERICA

By: /s/ Gregory S. Hrebiniak
GREGORY S. HREBINIAK, ESQUIRE